Independent Fiscal Institution

Fiscal Follow-Up Report

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HIGHLIGHTS

- The economic landscape brings good and bad news. On the positive side, GDP growth, employment rates, and household income have exceeded initial forecasts. Conversely, inflation, interest rates, the dollar, and fiscal uncertainties are trending upward.
- To meet the primary fiscal target of zero deficit, an additional fiscal effort of BRL42.3 billion is required in the last two months. Achieving the bound of the fiscal tolerance margin, as outlined in the fiscal framework, would require a smaller adjustment of BRL13.6 billion.
- Four public policy decisions have made the challenge of fiscal balance more complex, adding an estimated BRL2.3 to BRL3.0 trillion in expenditures over a decade.
- Unutilized budgetary allocations, reduced implementation of parliamentary amendments due to a Supreme Court ruling, higher-than-expected dividend transfers, strong performance of state-owned enterprises, and spending freezes or contingencies announced in the upcoming fifth bi-monthly report could facilitate compliance with the fiscal target
- The spending cut to be announced by the government has two possible paths: a short-term, short-breath adjustment to ensure compliance with the fiscal rule in 2025 and 2026, and a structural rearrangement to ensure long-term fiscal resilience and sustainability.
- Ongoing fiscal instability and fiscal and parafiscal measures contribute to a loss of anchoring in the expectations of economic agents and to a rise in inflation, interest rates, the dollar, and public debt
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The Independent Fiscal Institution (IFI) presents its Fiscal Follow-Up Report (RAF) No. 94, of November 2024, to the National Congress and Brazilian society.

From a macroeconomic perspective, while economic growth sustained by a robust labor market offer a positive outlook, inflation, interest rates, and currency depreciation have surprised analysts and exceed projections made at the end of 2023. Uncertainties regarding the correction of the fiscal imbalance, which is crucial for stabilizing the economy, may have introduced volatility into the expectations of economic agents and affected the dynamics of these variables. (**Page 6**)

Based on data available up to October, IFI identifies the need for an additional fiscal effort of BRL13.6 billion in the last two months of the year to meet the fiscal target set out in the 2024 budget guidelines. This corresponds to the lower bound of the tolerance margin of 0.25% of GDP, including legally authorized deductions (such as payments of registered warrants exceeding constitutional limits, financial support to Rio Grande do Sul, and wildfire mitigation efforts). If the goal were to achieve the center of the primary deficit target set for 2024, an additional fiscal effort of BRL42.3 billion would be required in November and December.

The unspent allocation of budgeted resources and the reduced execution of parliamentary amendments, impacted by the temporary suspension ordered by the Supreme Court, could help the Executive branch meet the 2024 fiscal target. The actions to be taken by the end of the year to achieve the fiscal target will be further detailed in the Fifth Bi-Monthly Assessment Report on Primary Revenue and Expenditures (RARDP), scheduled for publication by the end of November.

In addition to these factors on the expenditure side, it is possible that measures on the revenue side will be used to achieve the fiscal target for the year. For example, an extraordinary dividend payment from BNDES is expected, which has already transferred BRL10.1 billion to the Treasury this year. It is important to mention the divergence between the Treasury and the Central Bank regarding the accounting of certain revenues in the list of measures to offset payroll tax exemptions. For the purposes of calculating the fiscal target for the year, the Central Bank's criteria will prevail, which excludes judicial deposit transfers in closed cases and funds held in Caixa Econômica Federal from being considered as primary revenue. In addition, the performance of state-owned enterprises could impact the achievement of this year's primary target. **(Page 12)**

RAF No. 94 also analyses how government decisions made over the past few years have further complicated the challenge of fiscal balance and stabilization of the ratio between public debt and GDP. It is important to say that IFI is not in a position to make value judgments about the quality of a particular public policy or decisions made by the branches of government. The role of IFI is to monitor compliance with legal standards and track the trajectory of relevant fiscal variables, issuing alerts about potential non-compliance with legal provisions and the risks associated with such decisions.

In this regard, RAF No. 94 highlights four recent decisions (maintaining the Bolsa Família benefit at the pandemic-level amount, reinstating the constitutional minimums for education and health, returning to the rule of minimum wage adjustments tied to economic growth, and creating budgetary funds as part of the tax reform) that will lead to additional expenses of between BRL2.3 billion and BRL3.0 trillion over a 10-year horizon, depending on the assumptions and parameters used in medium- and long-term projections.

In addition, these recent decisions have been compounded by others that have affected the dynamics of central government spending, such as the increase in federal contributions to FUNDEB until 2026, the elimination of the delay in the payment of registered warrants in 2027, and the reinstatement of the link between parliamentary amendments and the federal government's net current revenue. **(Page 22)**

The federal government's revenue efforts have been successful, as evidenced by the significant growth in public revenues, as demonstrated here. However, the structural and permanent growth in expenditures, derived from decisions made regarding public policies, regardless of their merit, threatens the sustainability of the current fiscal framework.

The government is expected to announce adjustment measures and possible spending cuts in the coming days. There are two options: a short-term adjustment, with limited impact, to ensure compliance with fiscal rules in 2025 and 2026, and/or a structural adjustment aimed at restoring a more favorable scenario for fiscal balance over the next ten years.

Uncertainties about the consistency of fiscal policy and the adoption of fiscal and parafiscal measures that aim to implement public policies using resources outside the budget could contribute to the loss of anchoring of expectations about the sustainability of public finances and, consequently, the macroeconomic balance of the country.

Marcus Pestana
IFI Executive Director

Alexandre Andrade
IFI Director

Considerations on the nominal GDP estimate for 2024

Rafael Bacciotti

The 2024 economic outlook presents positive signals for economic activity, although it faces challenges related to persistent inflation. Sectoral data from the third quarter exceeded initial forecasts of a slowdown, and the labor market remains dynamic. In this context, inflation may end the year above target, driven by free prices, which are more sensitive to economic activity, the labor market, and the exchange rate. This article analyzes IFI's projections for GDP and inflation, which show an upward bias, and compares them with figures from the Focus Bulletin, the Secretariat for Economic Policy (SPE) and the Fiscal Prism. It should be noted that a more expressive growth in nominal GDP tends to generate positive impacts on some fiscal variables, contributing to a marginal improvement in the perception of the fiscal framework.

Economic Activity

The quarterly Gross Domestic Product (GDP) results for the period from July to September will be released by the Brazilian Institute of Geography and Statistics (IBGE) on December 3. In our assessment, economic activity is expected to slow down compared to the previous quarter, likely showing a lower variation than that recorded in the second quarter (1.4%, in the seasonally adjusted series). In any case, high-frequency data available for the third quarter indicates that economic activity remained robust, surpassing initial projections that predicted a sharper slowdown following the release of second-quarter GDP figures in August.

In the quarter ending in September, industrial production (PIM-IBGE), retail sales (PMC-IBGE), and the volume of services (PMS-IBGE) recorded growth rates of 1.6%, 1.0%, and 1.3%, respectively, compared to the previous quarter. These variations were higher than those seen in the quarter ending in June (0.8%, 0.3%, and 0.5%). Additionally, the Central Bank's Economic Activity Index (IBC-Br), which aggregates indicators from the agricultural, industrial, and services sectors, rose by 1.1% over the same basis of comparison, nearly matching the 1.2% growth recorded in the second quarter. The recent evolution of this data is summarized in Table 1.

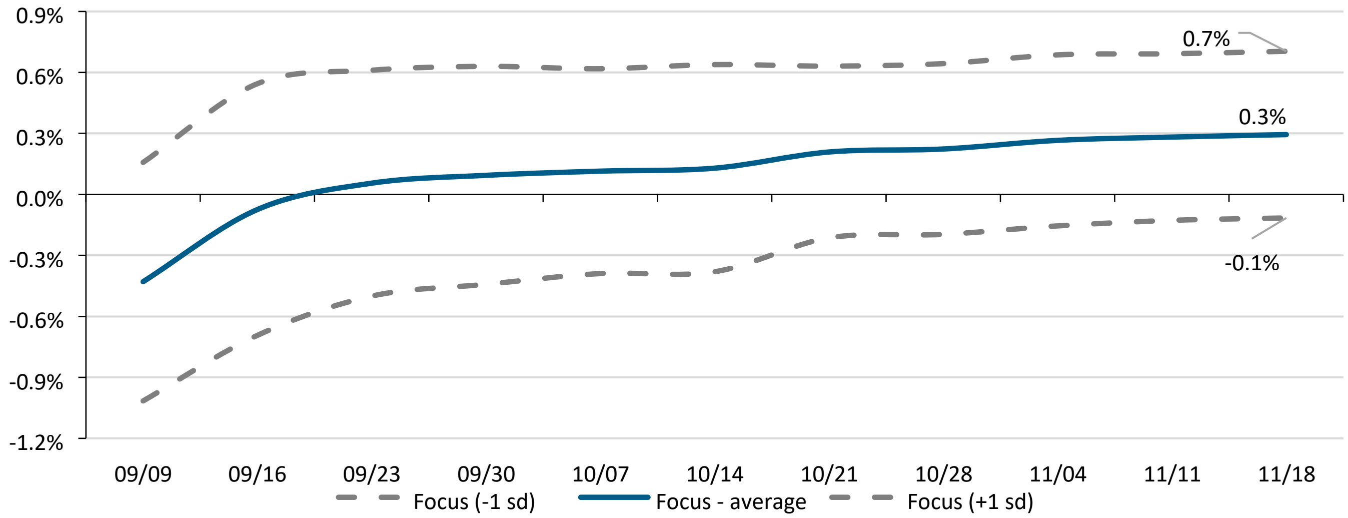
TABLE 1. ECONOMIC ACTIVITY DATA

Indicators	Variation in relation to the same month of the previous year			Variation in relation to the previous month (seasonally adjusted)			Variation in relation to the previous quarter (seasonally adjusted)	
	Jul-24	Aug-24	Sep-24	Jul-24	Aug-24	Sep-24	Jun-24	Sep-24
Industrial production	6.1%	2.3%	3.4%	-1.3%	0.2%	1.1%	0.8%	1.6%
Extended retail sales	7.3%	3.2%	3.9%	0.1%	-0.4%	1.8%	0.3%	1.0%
Volume of services	4.1%	1.9%	4.0%	0.3%	-0.3%	1.0%	0.5%	1.3%
IBC-Br	5.7%	3.4%	5.1%	-0.3%	0.2%	0.8%	1.2%	1.1%

Source: IBGE and Central Bank of Brazil. Prepared by: IFI.

Graph 1 shows the average of weekly projections for third quarter GDP growth compared to the previous quarter, as reported in the Central Bank's Focus Bulletin, along with a range of one standard deviation above and below these projections. It can be seen that GDP forecasts rose between the beginning of September (after the release of the second quarter's GDP) and mid-November, reflecting an adjustment in expectations about the economy's performance.

GRAPH 1. EVOLUTION OF GDP PROJECTIONS FOR THE THIRD QUARTER (FOCUS BULLETIN)



Source: Central Bank of Brazil. Prepared and seasonally adjusted by: IFI.

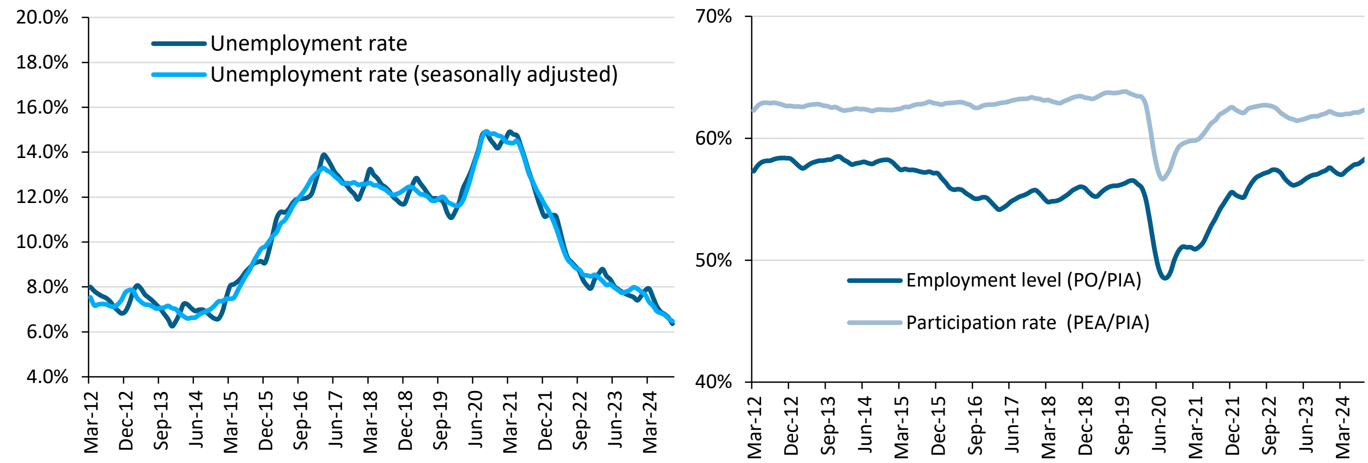
However, it is worth noting that the most recent forecasts in the Focus Bulletin indicate an expansion of just 0.3%, with a range between -0.1% and 0.7%. In contrast, IFI's estimate for third quarter GDP growth is 0.9%, revised upward in this RAF from the previous projection of 0.5%. Following the release of the third quarter result, the median market projections for annual GDP growth in 2024, currently at 3.1%, may be revised upward to around 3.5%. Similarly, IFI's projection for 2024 GDP, which is at 2.8%, is also likely to be adjusted upward.

Labor Market

In addition to the economic results of the third quarter mentioned above, the labor market continues to show a positive trajectory, with declining unemployment, increasing employment, and rising earnings. In the quarter ending in September, net job creation outstripped labor force growth, which led to the unemployment rate falling to 6.4% of the economically active population, a level very close to the historic low recorded by the Continuous National Household Sample Survey (Continuous PNAD). Compared to the same period last year, the unemployment rate fell by 1.3 percentage points (pp). During this time, the participation rate (labor force as a proportion of the working-age population) and the occupation level (employed population as a proportion of the working-age population) increased by 1.3 pp and 0.6 pp, respectively, as shown in Graph 2.

GRAPH 1. LABOR MARKET INDICATORS

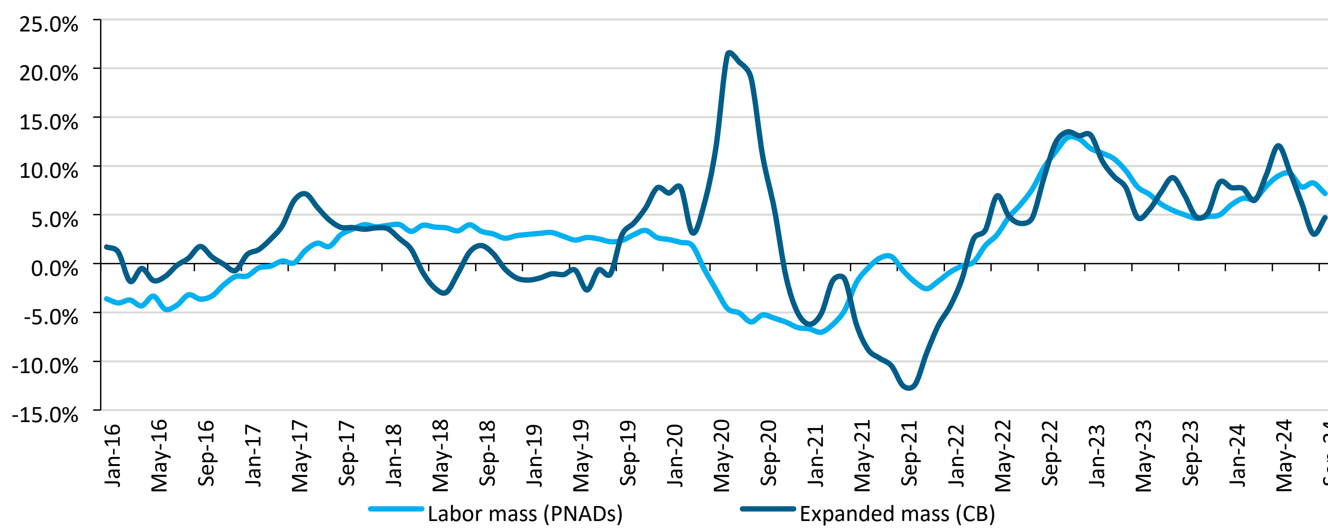
UNEMPLOYMENT RATE (% OF WORKFORCE) | **OCCUPATION LEVEL AND PARTICIPATION RATE**



Fonte: IBGE. Elaboração e ajuste sazonal: IFI.

Earnings continue to rise significantly, although there has been a recent slowdown. The usual labor income mass, measured by the Continuous PNAD in the period between July and September, grew by 7.2% compared to the same period last year, after rising by 8.3% in the previous quarter, in real terms. In turn, the expanded income mass, which includes other sources of income besides work, such as social security and social assistance benefits, rose by 3.0% and 4.7% in the quarters ending in August and September[1], respectively, according to Central Bank calculations. This growth in the expanded income mass has boosted families' ability to consume, positively contributing to economic activity.

GRAPH 3. YEAR-ON-YEAR CHANGE RATES IN THE WAGE BILL: LABOR AND EXPANDED



Source: IBGE and Central Bank of Brazil. Prepared by: IFI.

[1] That is, by comparing the quarters ending in those months with their counterparts in 2023: Jun-Aug/24 with Jun-Aug/23, and Jul-Sep/24 with Jul-Sep/23.

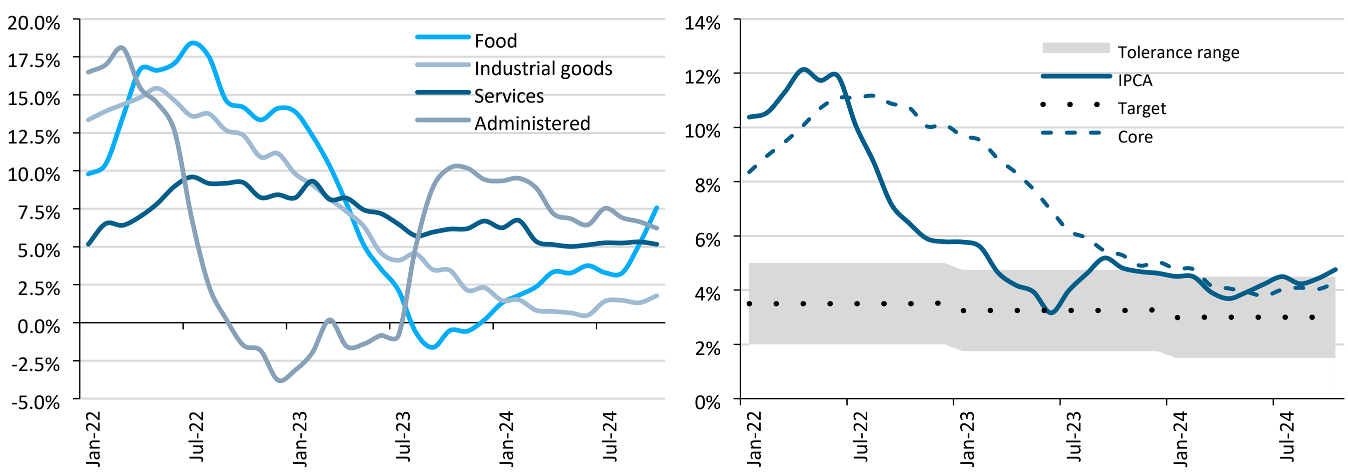
Inflation

Inflationary pressures remain elevated, with the Extended National Consumer Price Index (IPCA) likely exceeding the upper limit of the target set by the National Monetary Council (CMN), which is 3.0%, with a tolerance range of ±1.5 pp. Up to October, the accumulated variation of the IPCA over twelve months was 4.8%, an increase on the 4.4% recorded in September. Core inflation, which excludes more volatile items, remains above 4.0%, reinforcing the perception that the inflationary outlook remains challenging. IFI's projection for the 2024 IPCA, considering the 12-month accumulated variation through December, is 4.4%, with an upward bias.

In particular, inflation in the services segment, which is highly sensitive to labor market conditions and the dynamics of economic activity, has remained stable at around 5.0% since March of this year. In addition, there has been a recent acceleration in prices in the food and industrial goods sectors, which contributes to continued inflationary pressures.

GRAPH 4. IPCA (ACCUMULATED VARIATION OVER TWELVE MONTHS)

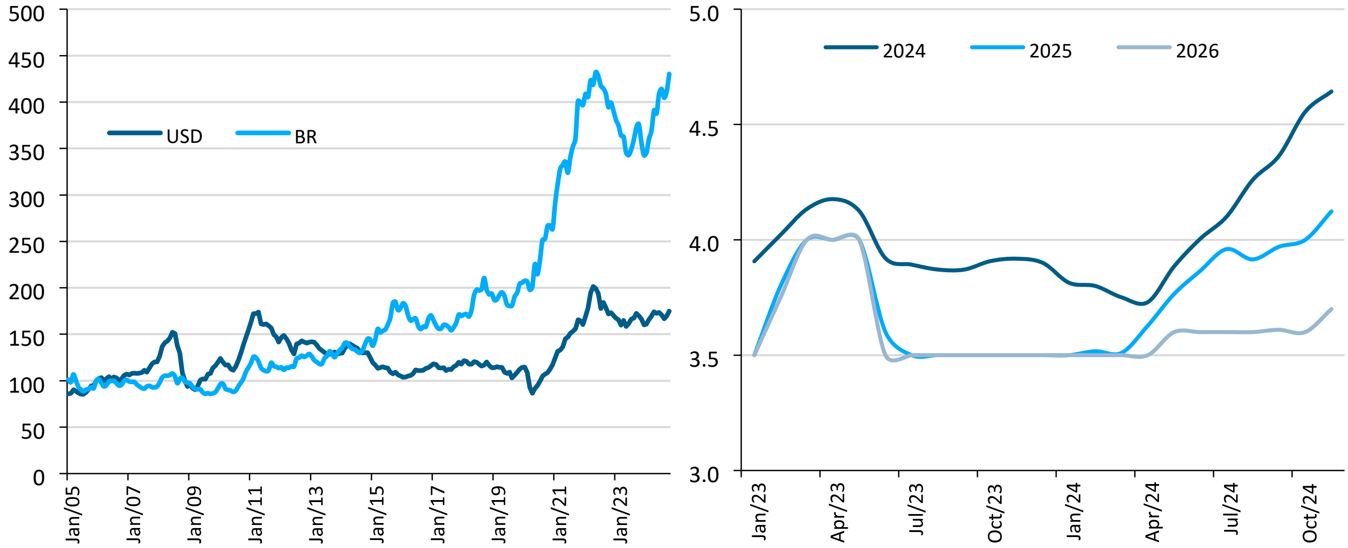
FREE AND ADMINISTERED PRICES **CORE AND TARGET**



Source: IBGE and Central Bank of Brazil. Prepared by: IFI.

Commodities prices relevant to the dynamics of Brazilian inflation, measured in dollars, remain at historically high levels, although they are on a stable trajectory. The depreciation of the real has led to an increase in these prices when quoted in domestic currency. This situation, combined with the robust performance of economic activity and the labor market, indicates an upward adjustment in inflation expectations for the coming years. As a result, the Central Bank has adopted a restrictive stance in its monetary policy.

GRAPH 5. COMMODITY INDEX AND INFLATION EXPECTATIONS COMMODITY INDEX INFLATION EXPECTATIONS: FOCUS



Source: Central Bank of Brazil. Prepared by: IFI.

Impacts on nominal GDP

Table 2 shows the projections for nominal GDP (in billions of reais) and the change rates (nominal GDP, real GDP, and GDP deflator) from IFI, the Secretariat for Economic Policy (SPE)[2], and the Prisma Fiscal Bulletin[3], highlighting some discrepancies between the forecasts.

TABLE 2. NOMINAL GDP PROJECTIONS: IFI, SPE, AND PRISMA FISCAL

	2024	2025	2024	2025	2024	2025
	IFI		SPE		Prisma Fiscal	
Nominal GDP (BRL billion)	11,579	12,249	11,640	12,626	11,660	12,395
Nominal GDP - Change (%)	6.7	5.8	7.2	8.5	7.4	6.3
Real GDP - Change (%)	2.8	1.8	3.3	2.5	2.9	1.5
GDP deflator - Change (%)	3.7	3.9	3.9	5.9	4.4	4.7
IPCA - Accumulated change (%)	4.4	3.7	4.4	3.6	-	-

Source: IFI and SPE. Prepared by: IFI.

For 2024, IFI projects nominal GDP growth of 6.7%, consisting of a 2.8% real growth rate and an implicit deflator of 3.7%. In nominal terms, this would represent a GDP of BRL11.6 trillion. For 2025, the projection is a 5.8% increase, composed of 1.8% real growth and an implicit deflator of 3.9%, which would imply a GDP of BRL12.4 trillion.

However, these projections have an upward bias, especially due to GDP growth in volume in 2024. For 2025, the ***carry-over*** effect— the contribution of the previous year's growth to the growth of the following year— may be higher, but its impact is likely to be mitigated by a more intense monetary tightening cycle than initially forecast. The worsening inflation scenario should also have some effect on the current projection for the implicit GDP deflator. IFI's projections will be revised in the December **Fiscal Follow-Up Report (RAF)**, covering both the short and medium term.

[2] Available at: https://www.gov.br/fazenda/pt-br/orgaos/spe
[3] Available at: https://www.gov.br/fazenda/pt-br/central-de-conteudo/publicacoes/relatorios-do-prisma-fiscal/relatorio-mensal/2024

Higher-than-expected nominal GDP growth tends to improve certain fiscal indicators. This happens because a larger GDP increases the denominator of fiscal variables expressed as a proportion of GDP, thereby reducing these ratios and enhancing the perception of the fiscal picture.

Considerations on meeting the 2024 primary result target

Alexandre Andrade and Pedro Souza

According to information gathered by IFI up to October, the Executive would need to make a fiscal effort of BRL13.6 billion in the last two months of the year to reach the lower bound of the tolerance interval to meet the zero primary deficit target set for 2024. This effort may become easier if the limitation on the execution of parliamentary amendments imposed by the Supreme Court in August persists, as well as the potential unspent budgetary resources, a phenomenon that tends to occur regularly. In addition, on the revenue side, although unlikely, any positive surprises could help to meet the target.

Initial considerations

Based on the latest information from the National Treasury Secretariat (STN), the Siga Brasil Portal, the Assessment Report on Primary Revenue and Expenditures (RARDP) for the 4th Quarter of 2024[4], and the most recent short-term projections presented by IFI[5] in September 2024, it can be said that the possibility of meeting the central government's primary result target for 2024 has increased. However, this scenario is not included in IFI's most recent projections.

According to data compiled by IFI updated up to October, an additional BRL13.6 billion would be need to reach the lower bound of the tolerance range for the fiscal target set for 2024 in the final two months of the year. This figure is influenced by the decision of the Supreme Court (STF) to suspend the implementation of parliamentary amendments in August[6].

Of the BRL45.3 billion allocated for the payment of amendments for the year, including individual, group and committee amendments, BRL28.4 billion had been paid as of October[7]. This amount includes the unpaid obligations from previous years that were settled in 2024. This means that BRL16.9 billion remain available to be executed in amendments, but cannot be used at the moment due to the STF's decision.

Considering that there are still two months to go until the end of the fiscal year, meeting this year's primary result target may become easier. Of course, surprises in revenue may also contribute to achieving the target for the year, such as possible payments of dividends by state-owned companies or even the materialization of measures provided for in LOA 2024.

It is worth mentioning that, despite the Treasury considering some revenue sources expected to offset the payroll tax exemption as primary revenue, which will improve the calculation of the primary result above the line, the Central Bank will treat these sources as financial revenue. This will not affect the primary result calculated using the criterion below the line. The two measures that fall under this situation are the transfer of frozen funds from Caixa Econômica Federal (carried out in October) and the transfer to the Treasury of amounts related to judicial deposits in closed cases.

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[4] Available at: https://tesourotransparente.gov.br/publicacoes/relatorio-de-avaliacao-de-receitas-e-despesas-primarias-rardp/2024/16.

[5] Document access page: https://www2.senado.leg.br/bdsf/bitstream/handle/id/660075/RAF92_SET2024.pdf.

[6] The suspension of the execution of committee and rapporteur amendments was based on the Argument for Failure to Comply with a Fundamental Precept (ADPF) 854 and the Direct Action for Unconstitutionality (ADI) 7688. In turn, the execution of PIX amendments and mandatory amendments was carried out through ADI 7695 and ADI 7697. To address the issue and regulate the proposal and execution of parliamentary amendments in the Annual Budget Law, Bill of Supplementary Lay (PLP) No. 175 of 2024 was proposed. It was approved by the Chamber of Deputies on November 5, 2024, and is currently under review in the Federal Senate.

[7] In August 2024, the Supreme Court imposed restrictions on the execution of parliamentary amendments. Up until that month, the executed amendments totaled BRL27.8 billion. The decision included the possibility of continuing the execution of certain amendments, namely those related to situations of public calamity and those that involved expenses that had already been initiated.

In any case, even if considered as financial revenue, the amounts mentioned will contribute to reducing the general government's gross indebtedness for the year.

The 2024 Budget Guidelines Law (LDO 2024) also follows for compensation between the targets set for the central government and federal state-owned enterprises. This could help in meeting the primary result target if the state-owned companies' primary result assessment offers room and the central government's result assessment presents a risk of non-compliance in the next RARDP[4]. On the other hand, it could represent a risk factor if the projection for the results of state-owned enterprises worsens, which would require a tightening of the central government's target.

Primary result of the central government in 2024 up to October

Based on information gathered by IFI on the Siga Brasil Portal[5], the central government accumulated a primary deficit of BRL62.9 billion between January and October 2024, compared to a deficit of BRL105.2 billion in the first nine months of the year. The improvement in the primary result in October compared to September was mainly due to the behavior of tax collection. For illustrative purposes, in October alone, the central government is expected to have a primary surplus of BRL 42.3 billion, according to data collected from the Siga Brasil Portal, which is not official. Of this amount, BRL34.7 billion would correspond to a recurring primary result, according to the methodology used by IFI and described in Special Study (EE) No. 17[6] of December 2021.

Also according to the methodology used by IFI to calculate the recurring primary result, BRL8.5 billion of October's net revenue of BRL210.9 billion was due to non-recurring events. Of this amount, BRL6.2 billion of which came from frozen deposits at Caixa Econômica Federal, one of the measures outlined in Law No. 14973 for offsetting the payroll tax exemption.

Table 3 shows figures for the central government's primary result over the last three years, in the first 10 months of the respective financial years. In 2024, total primary revenue grew by 7.6% in real terms in the first ten months of the year, compared to a drop of 4.0% in 2023. Revenue performance in the year was driven by administered revenue (+12.7%) and net collection for the General Social Security System (RGPS) (+3.9%). Net primary revenue had a real increase of 7.0% in 2024, compared to a reduction of 3.3% last year (Table 3).

TABLE 3. CENTRAL GOVERNMENT PRIMARY RESULT (ACCUMULATED FROM JANUARY TO OCTOBER, BRL BILLION AND REAL CHANGE %)

Primary revenues and expenditures	Jan-Oct 2022		Jan-Oct 2023		Jan-Oct 2024	
	Current BRL billion	Real change (%)	Current BRL billion	Real change (%)	Current BRL billion	Real change (%)
1. Total primary revenue	1,927.4	12.8%	1,935.8	-4.0%	2,172.0	7.6%
2. Revenue sharing transfers	369.1	20.3%	360.5	-6.6%	414.3	10.2%
3. Net primary revenue [1-2]	1,558.3	11.2%	1,575.2	-3.3%	1,757.7	7.0%
4. Primary expenditure	1,499.1	2.6%	1,651.4	5.4%	1,820.6	5.8%
5. Conventional primary result [3-4]	**59.2**	-	**-76.2**	-	**-62.9**	-

[8] According to Paragraph 2 of Article 3 of Law No. 14791 of 2023: "Paragraph 2. During the execution of the 2024 Budget Law, as demonstrated in the reports referred to in Paragraph 4 of Article 71 and the **head paragraph** of Article 158, compensation may occur between the targets set for the Fiscal and Social Security Budgets and for the Global Expenditure Program referred to in the **head paragraph**". Available at: https://www.planalto.gov.br/ccivil_03/_ato2023https://www.planalto.gov.br/ccivil_03/_ato2023-2026/2023/lei/L14791.htm2026/2023/lei/L14791.htm.

[9] Available at: https://www12.senado.leg.br/orcamento/sigabrasil.

[10] Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/594656/EE17_Resultado_Estrutural.pdf.

Primary revenues and expenditures	Jan-Oct 2022		Jan-Oct 2023		Jan-Oct 2024	
	Current BRL billion	Real change (%)	Current BRL billion	Real change (%)	Current BRL billion	Real change (%)
6. Total recurrent primary revenue	1,830.1	11.5%	1,911.2	-0.1%	2,118.5	6.3%
7. Recurrent revenue sharing transfers	347.9	18.4%	358.9	-1.3%	401.6	7.3%
8. Recurrent net primary revenue [6-7]	1,482.2	10.0%	1,552.3	0.2%	1,716.8	6.1%
9. Recurrent primary expenditure	1,434.3	8.7%	1,660.4	10.7%	1,816.0	5.0%
10. Recurrent primary result [8-9]	**47.9**	-	**-108.1**	-	**-99.2**	-
11. Total non-recurring primary revenue	97.2	45.1%	24.6	-76.1%	53.5	111.3%
12. Non-recurrent revenue sharing transfers	21.1	63.2%	1.6	-92.6%	12.7	645.2%
13. Non-recurrent net primary revenue [11-12]	76.1	40.8%	22.9	-71.5%	40.8	72.6%
14. Non-recurrent primary expenditure	64.8	-54.5%	-9.0	-113.0%	4.5	-149.2%
15. Non-recurrent primary result [13-14]	**11.3**	-	**31.9**	-	**36.3**	-

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

Primary expenditure increased by 5.8% in real terms in the first ten months of 2024. In 2023, expenditure had grown by 5.4% on this basis of comparison. This year, the lower growth in primary expenditure in relation to net revenue allowed for a reduction in the primary deficit recorded from January to October, compared to 2023. It is also worth mentioning two aspects: the improvement in the recurring primary result between 2023 and 2024 (a deficit of BRL99.2 billion in 2024, compared to a deficit of BRL108.1 billion in 2023) and the increase in the non-recurring primary result.

Also according to the data reproduced in Table 3, in 2024 up to October, non-recurring (or atypical) events accounted for BRL53.5 billion of total primary revenue and BRL40.8 billions of net primary revenue. Of the BRL53.5 billion in extraordinary revenue recorded this year, BRL8.4 billion was due to special recovery programs (REFIS), BRL5.0 billion to the advance payment of dividends from Petrobras, BRL22.8 billion to income tax payments on exclusive funds and offshores, BRL9.2 billion corresponded to the PGFN-RFB 6/2024 tax settlement with Petrobras, and BRL6.2 billion was due to the regularization of deposits at Caixa Econômica Federal[7].

For the purpose of meeting the 2024 primary result target, Table 4 presents an update of an exercise carried out by IFI and presented in the aforementioned RAF No. 91, of August 2024, which indicates the primary result required to meet the zero primary deficit target for the year, in the remaining months of the year.

[11] It's worth noting that, despite the National Treasury Secretariat considering these BRL6.2 billion as primary revenue, the Central Bank will probably classify them as financial revenue. In other words, for the purposes of meeting the 2024 primary result target, this amount will reduce indebtedness, but not the central government's primary deficit.

TABLE 4. EXERCISE CARRIED OUT BY IFI TO ASSESS THE FISCAL EFFORT REQUIRED TO MEET THE 2024 FISCAL TARGET

Breakdown	Result (BRL billion)
1. Primary result target for 2024	0.0
Lower bound of the primary result target for 2024	-28.8
3. Accumulated primary result from January to October 2024	-62.9
4. Deductions from the target for the year (accumulated from January to October)	20.6
5. Primary result to meet target (accumulated from January to October) [3+4]	- 42.3
6. Primary result required to meet the center of the target between November and December [1-5]	42.3
7. Primary result required to meet the lower bound of the target between November and December [2-5]	**13.6**

** The BRL20.6 billion in deductions represents the sum of expenses for the disaster in Rio Grande do Sul, in the amount of BRL18.8 billion, the extraordinary credit in favor of various bodies of the Judiciary, in the amount of BRL1.2 billion, and the extraordinary credit for the climate emergency, in the amount of BRL0.5 billion.*
Source: RARDP 4th Bimester 2024, Decree No. 12204 of September 30, 2024, and IFI. Prepared by: IFI.

According to Table 4, excluding the deductions provided for in the legislation, it would be necessary to improve the primary result accumulated up to October by BRL42.3 billion, between November and December, in order to reach the center of the target set for the year. However, in order to meet the target it is sufficient to reach the lower bound of the tolerance range, i.e. -0.25% of GDP. Thus, the required improvement in the primary result, taking into account the figures up to October, would be BRL13.6 billion in the last two months of the year.

By the end of the fifth bimester, the limit for the payment of discretionary expenditures, which are expenses that can be compressed, is BRL 162.7 billion. The data indicates that BRL140.8 billion has been paid out so far. As a result, IFI estimates a total of BRL21.9 billions of discretionary funds unspent[12], of which BRL11 billion in discretionary spending by the Executive Branch and BRL10.9 billion in parliamentary amendments[13].

If the level of unspent funds in the last two months of the year is the same as the one observed until the 5th bimester, the possibility of meeting the primary result target is higher. However, this could jeopardize the achievement of the fiscal target for 2025. As will be discussed in the next section, meeting the primary result target in 2024 will depend mainly on the evolution of revenues and the execution of parliamentary amendments, which have been partially suspended since August.

Assessment of the possibility of meeting the 2024 target in light of the 4th Bimester RARDP

Table 5 summarizes the Executive's projections for the central government's primary result in 2024, updated in the aforementioned RARDP for the 4th Bimester, along with the most recent projection from IFI. These are detailed in the also referenced RAF No. 92, of September 2024, which includes a similar table based on data from the RARDP for the 3rd Bimester of 2024 and IFI's projections published in June.

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[12] Unspent budget refers to the difference between the authorized payment limits and the amounts actually paid in a given period.
[13] Even if the execution of parliamentary amendments had not been limited by the Supreme Court, the observed result in September and October would likely have been similar. This is because the amendments had been experiencing low execution levels since mid-July due to the electoral period, which prohibits voluntary transfers in the three months prior to the elections. See subitem “a” of item VI of Article 73 of Law No. 9504, of 1997. Available at: https://www.planalto.gov.br/ccivil_03/leis/l9504.htm.

Between the 3rd Bimester and 4th Bimester RARDP, the Executive kept the projection for total primary revenue practically unchanged (BRL2,700.1 billion in the 4th Bimester RARDP, equivalent to 23.2% of GDP, against BRL2,698.1 billion in the 3rd Bimester RARDP, equivalent to 23.4% of GDP). The estimate for net revenue, in turn, also remained practically unchanged (BRL2,172.6 billion in the 4th Bimester RARDP, equivalent to 18.7% of GDP, compared to BRL2,168.3 billion in the 3rd Bimester RARDP, equivalent to 18.8% of GDP). Although the Executive has revised downwards the projection for revenues from CARF judgments, there have been upward adjustments in other sources of revenue, such as income from the exploitation of natural resources.

For primary expenditures, the Executive revised the figures from BRL2,229.6 billion (19.4% of GDP) in the 3rd Bimester RARDP to BRL2,237.7 billion (19.3% of GDP) in the 4th Bimester RARDP. After making the adjustments in relation to the expenditure reductions in the 2024 target, the Executive would have a gap of BRL0.4 billion towards the lower bound of the target, according to the projections presented in the 4th Bimester RARDP.

IFI, in turn, revised its projection for the central government's total primary revenue for 2024 in September, from BRL2,652.8 billion (22.9% of GDP) to BRL2,641.0 billion (22.8% of GDP). For net revenue, the revision was from BRL2,138.6 billion (18.5% of GDP) to BRL2,121.4 billion (18.3% of GDP)[8]. In general terms, this downward revision in the short-term revenue projection reflected changes in expectations regarding CARF collections and the amounts expected to offset the payroll tax exemption, as outlined in Law No. 14973 of September 16, 2024.

Also according to the projections presented by IFI in September, the central government would have a primary deficit of BRL95.7 billion (0.8% of GDP) in 2024. Excluding the deductions provided for in the legislation, the projected primary deficit is BRL74.9 billion (0.6% of GDP) to meet the center of the target, and BRL46.2 billion (0.4% of GDP) if the lower bound of the tolerance range is considered.

[14] The explanation for the change in projections can be found in RAF No. 92, of September 2024, a document already referenced in this text.

TABLE 5. EXECUTIVE AND IFI PROJECTIONS FOR THE CENTRAL GOVERNMENT'S PRIMARY RESULT IN 2024

Breakdown	RARDP 4th bimester and Decree No. 12204, of September 30, 2024		IFI (Sep/24)		Difference IFI (Sep/24) and RARDP 4th bimester	
	BRL billion	% GDP	BRL billion	% GDP	BRL billion	% GDP
1. Total primary revenue	2,700.1	23.2	2,641.0	22.8	-59.1	-0.4
2. Revenue sharing transfers	527.5	4.5	519.7	4.5	-7.8	-0.1
3. Net primary revenue [1-2]	2,172.6	18.7	2,121.4	18.3	-51.3	-0.4
4. Primary expenditure	2,241.5	19.3	2,217.1	19.1	-24.4	-0.1
5. Central government primary result [3-4]	-68.8	-0.6		-95.7	-26.9	-0.2
6. Primary result target (LDO 2024)	0.0	0.0		0.0		
7. Lower bound for the primary result target (LDO 2024)	-28.8	-0.25	-28.8	-0.25	0.0	0.0
8. Expenditure not included in the primary result (RS disaster and Appellate Decision 1103/2024-TCU)*	40.5	0.3	37.3	0.3	-3.2	0.0
9. Primary result for compliance with LDO 2024 [5+8]	-28.3	-0.2		-58.4	-30.1	-0.3
10. Adjustment to target [9-6]	**-28.3**	**-0.2**	**-58.4**	**-0.5**		
11. Adjustment to the lower bound of the target [9-7]	**0.4**	**0.0**	**-29.7**	**-0.3**		

** Until the RARDP for the 4th Bimester of 2024, expenses not considered in the target amounted to BRL40.49 billion. At the end of September and in October, BRL6.7 billion was canceled, under the terms of Provisional Measure No. 1225, of May 24, 2024, in addition to the opening of another BRL2.1 billion in credits for addressing the Public Calamity in Rio Grande do Sul and BRL0.9 billion for tackling the Climate Emergency. It is therefore possible that the amount estimated in the next RARDP will be reduced to BRL36.7 billion if no new credits are opened in the period. Source: RARDP for the 4th Bimester of 2024 and IFI. Prepared by: IFI.*

In light of the information provided in Table 5, the Executive would need an additional BRL 42.3 billion to meet the center of the primary target set for 2024, or BRL 13.6 billion to reach the lower bound of the target tolerance range. This amount of BRL13.6 billion could be achieved with greater effectiveness of some measures foreseen in the 2024 LOA[15], with a positive revenue surprise due to the dynamics of economic activity, other measures to offset payroll tax exemption, or even with the non-execution of the remaining parliamentary amendments authorized for 2024.

On the revenue side, as warned in previous editions of this RAF, some measures intended by the Executive in the 2024 LOA to increase revenue for the year have a high level of uncertainty regarding their materialization and have resulted in low resource inflows into public coffers, such as the amounts anticipated in the CARF judgments. Other measures, such as the exclusion of ICMS from the calculation basis of PIS/COFINS credits, have contributed to an increase in revenue, although the information provided by the Federal Revenue Service (RFB) and the STN is insufficient for a better assessment of the effectiveness of these measures.

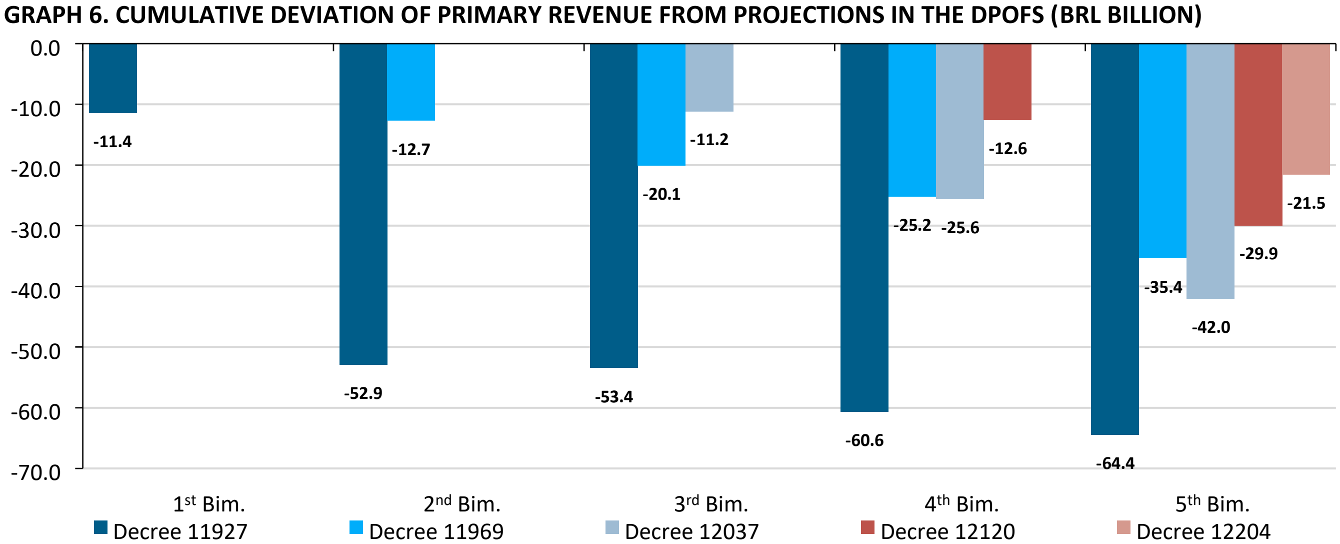
[15] See Table 5 of RAF No. 92, of September 2024, a document already referenced in this text.

To illustrate the possibility of a revenue surprise in the last two months of the year, a consideration is made regarding the behavior of revenues in September and October *vis-à-vis* the figures projected by IFI in September. For the central government's net primary revenue in September and October, IFI projected an amount of BRL367.1 billion. Considering the figures in the National Treasury Result (RTN) and those collected by IFI on the Siga Brasil Portal, net revenue was BRL 373.6 billion in the period, exceeding projections by BRL 6.5 billion. This deviation between IFI's estimate and the actual figures was mainly due to administered revenue, which was BRL21.0 billion higher than projected. Conversely, net revenue for the RGPS and non-administered revenues underperformed IFI projections by BRL4.4 billion and BRL7.1 billion, respectively, in September and October.

As a potential source of extraordinary revenue in the final months of the year, an extraordinary collection of dividends from state-owned enterprises can be highlighted. By way of illustration, in the year to October 2024, the federal government collected BRL41.3 billion in dividends and participations. Of this amount, BRL10.1 billion came from payments made by BNDES, BRL5.6 billion from Banco do Brasil, BRL2.8 billion from Caixa Econômica Federal, and BRL20.0 billion from Petrobras. IFI forecasts a total dividend collection of BRL66.1 billion in 2024, considering payments to be made mainly by BNDES and Petrobras in the last two months of the year.

Despite the positive revenue surprise in October, it is important to highlight that the performance of primary revenue has fallen short of the levels anticipated by the Executive in the budget law and in the budget programming decrees published throughout the year. This can be seen in Graph 6, which illustrates the cumulative deviation throughout the year (up to the month immediately preceding the publication of the respective decree) between expected and realized revenue. It is clear that the bimonthly execution of primary revenues was not met in any of the programming decrees, with a revenue shortfall of BRL21.5 billion up to the 5th bimester of the year, in relation to the forecast, considering the most recent decree (Decree No. 12204[9] of September 30, 2024).

GRAPH 6. CUMULATIVE DEVIATION OF PRIMARY REVENUE FROM PROJECTIONS IN THE DPOFS (BRL BILLION)



Source: Budgetary and Financial Programming Decrees (DPOF) and Siga Brasil. Prepared by: IFI.

On the expenditure side, there is uncertainty regarding the execution of parliamentary amendments in the last two months of the year, which may or may not make it easier to meet the fiscal target set for 2024. This is because, according

[16] Available at: https://www.planalto.gov.br/ccivil_03/_ato2023-2026/2024/decreto/D12204.htm.

to information gathered by IFI on the financial execution of these amendments, of the BRL45.3 billion payment limit set out in Decree No. 12204, BRL28.4 billion had been paid by October, including unpaid obligations from previous years. Thus, considering the amounts in Decree No. 12204 and the execution up to October, BRL16.9 billion in parliamentary amendments remain to be paid this year.

Of these BRL16.9 billion, BRL13.2 billion are individual and group amendments, which are mandatory. These can only be reduced through budget freezes, up to the same proportion as the ones applied to other discretionary expenses, when the RARDP indicates a risk of non-compliance with the primary result target, or due to technical limitations[10]. The remaining BRL3.6 billion represent committee amendments, subject to limitations arising from the risk of non-compliance with the primary result target or the primary expenditure limit.

It's important to say that if the BRL16.9 billion (or part of that amount) of amendments within the payment limit set out in Decree No. 12204 of 2024 are not paid this year, there is a possibility that at least part of these amounts will be recorded as unpaid obligations at the end of the year. This would put pressure on expenses in 2025 and subsequent years. Considering, furthermore, that individual and group amendments are mandatory, there would be no possibility of blocking and subsequently canceling these unpaid obligations[11]. As of October 2024, BRL37.6 billion of parliamentary amendments had been committed, which, considering the difference in relation to the amounts paid out during the year, could imply BRL14.3 billion in unpaid obligations for the coming years, if these payments are not normalized by the end of December[12].

In any case, there is uncertainty as to the execution of the remaining portion of these expenses, a result of the legal discussions involving parliamentary amendments, which may contribute to an improvement in the result in 2024 and a worsening in the following years[13].

It is also important to consider that, historically, the financial execution of discretionary and mandatory expenses with flow control tends to be higher in the last two months of the year. This is due to the caution in containment in the previous two months or in the expense execution schedules, which ensures a "surplus" in the payment limit established in the budget and financial programming decrees. In this way, it would be reasonable to assume that there could be financial execution exceeding the values observed in previous bimesters. However, the possibility of unspent funds still persists, which could reduce the amounts paid during the year and facilitate meeting the primary result target for 2024.

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[17] For illustration purposes, let's assume that discretionary expenses total BRL100 billion, of which BRL10 billion are from mandatory amendments. If there is a need to limit spending by BRL10 billion in order to meet the primary result target (a contingency), the mandatory amendments, which represent 10% of the total discretionary spending, can only be reduced by 10% of their total value. As a result, if BRL10 billion were to be set aside, mandatory amendments could make up a maximum of BRL1 billions of this amount, with the rest being left to non-mandatory amendments and other discretionary spending. Under the terms of items II and III of §3º of art. 68 of Decree nº 93.872, of 1986. As a result, if BRL10 billion are to be set aside, mandatory amendments could make up a maximum of BRL1 billions of this amount, with the rest being covered by non-mandatory amendments and other discretionary spending.

[18] Under the terms of items II and III of Paragraph 3 of Article 68 of Decree No. 93872, of 1986. Available at: https://www.planalto.gov.br/ccivil_03/decreto/d93872.htm.

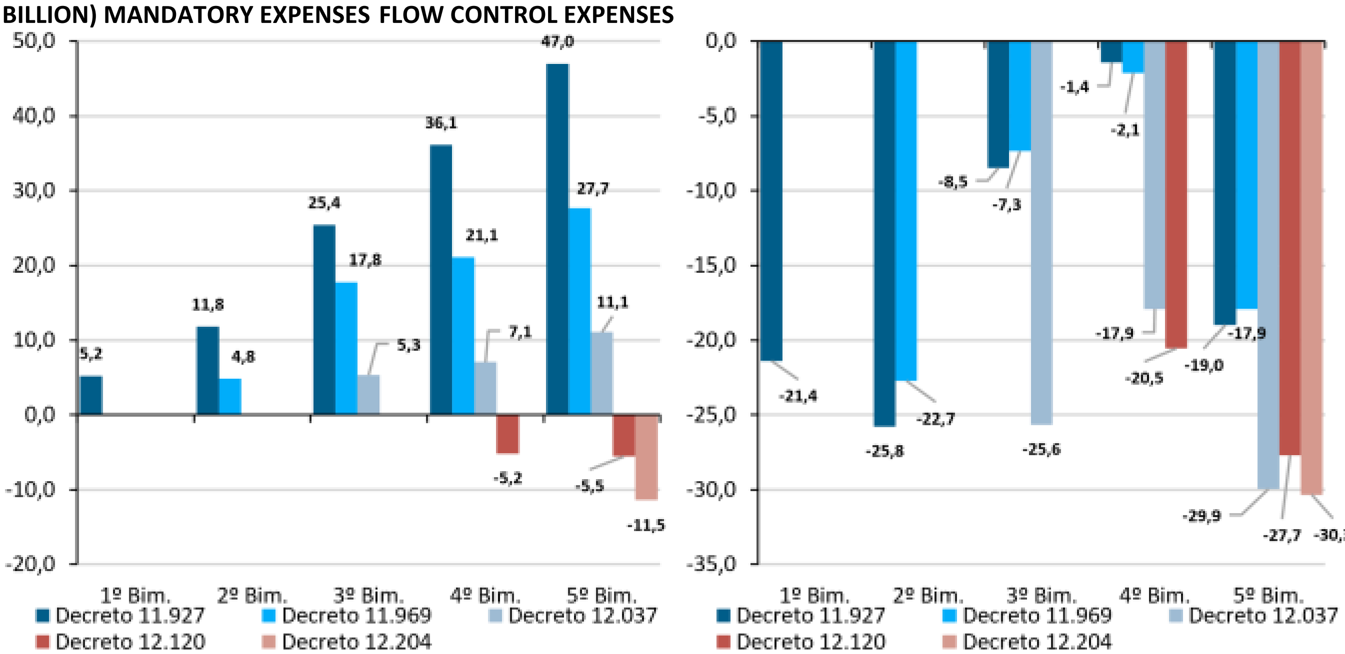
[19] Of the BRL28.4 billion paid in 2024, BRL23.3 billion are expenses committed and paid in 2024, while BRL5.1 billion represent amendments committed or settled in previous years and paid in 2024, as unpaid obligations.

[20] On this subject, RAF No. 86, of March 2024, presents an analysis of the evolution of the stock of unpaid obligations and its conditioning factors. Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/648335/RAF86_MAR2024.pdf.

It is also worth noting that the last two DPOFs showed negative deviations between the executed and projected expenditure values, both in the fourth and fifth bimesters of 2024. Thus, considering the data up to October, the last two revisions showed a reversal in the accumulated deviations of mandatory expenses, which, up to the 5th bimester, were BRL11.5 billion lower than forecast for the period in Decree No. 12204. This resulted from the combination of a lower execution of BRL12.9 billion in other mandatory expenses and personnel and charges, in addition to an execution above the forecast of BRL1.5 billion in social security benefits (Graph 7).

In flow control expenses, the deviations already totaled BRL30.3 billion up to the fifth bimester of the year, due to lower execution of mandatory flow control expenses (a deviation of BRL8.4 billion), parliamentary amendments (a deviation of BRL10.9 billion), and discretionary expenses of the Executive Branch (a deviation of BRL11.0 billion), considering the values set out in Decree No. 12204 of 2024.

GRAPH 7. CUMULATIVE DEVIATION OF PRIMARY EXPENSES FROM PROJECTIONS IN THE DPOFS IN EACH BIMESTER (BRL BILLION) MANDATORY EXPENSES FLOW CONTROL EXPENSES



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

Final considerations

In light of the above, it is clear that the lower bound of the primary result target set for 2024 (-0.25% of GDP, or BRL28.8 billion) can be met. A fiscal effort of around BRL13.6 billion in the last two months of the year would guarantee compliance with the result target set for the central government, according to data from the STN and information gathered by IFI on the Siga Brasil Portal.

Considering the information in Decree No. 12204, of 2024, and based on the estimate of a BRL 21.9 billions of unspent funds between January and October, meeting the target would be easier, although this movement would increase the pressure on primary results in the coming years, due to the possibility of recording unused resources as unpaid obligations.

Also on the expenditure side, uncertainties associated with the implementation of parliamentary amendments could also contribute to meeting this year's primary target, given the factors that could prevent their full execution, such as legal discussions about the constitutionality of the amendments and the relatively tight deadline for implementing these expenses in 2024.

On the revenue side, although October's result was a surprise, caution is needed with regard to revenue performance in the last two months of the year, due to the prospect of a slowdown in economic activity. As can be seen from the comparison of realized revenue data with that estimated in the budget programming decrees, there have been repeated revenue frustrations throughout 2024, which reinforces the assessments made by IFI in relation to the relative optimism with some of the measures intended to increase revenue in 2024 and in the coming financial years.

Short-term measures may not be enough to anchor medium-term expectations

Eduardo Nogueira

Constant announcements of spending review measures with low implementation, accompanied by increases in revenues, which are generally cyclical, as well as the adoption of measures that can bypass budgetary and fiscal rules, and the use of discounts to achieve fiscal targets, are contributing to the scenario of loss of anchoring of medium-term expectations. The magnitude of the fiscal expansion, caused by measures adopted during the transition and in the first year of government (with an estimated cost of between BRL2.3 trillion and BRL3 trillion over ten years), and the rigidity of the budget, form the perception that short-term measures will not be enough to reverse the unsustainability of the fiscal framework's spending limit, and may only postpone the need to change the regulations in the medium term.

New rules and old challenges for fiscal stability

In RAF No. 84[21], of January 2024, IFI took stock of 2023 and presented some reflections on the new rules proposed by the Sustainable Fiscal Regime (SFR) and the old challenges to the Union's fiscal stability that remained present despite the new framework. The text emphasized that the new fiscal rules would have to respond to the old challenges of fiscal stability, which had compromised the credibility of both the Fiscal Responsibility Law[22] (LRF) and the Spending Limits[23].

Budgetary rigidity, growing social demands, an increase in mandatory spending, and parliamentary amendments were pointed out as the main challenges on the public spending side. It was also pointed out that there were doubts about the ability to expand revenues on a recurring basis in order to relieve the government of the need to make additional efforts to contain spending in the short term, especially in the face of a macroeconomic outlook that, up to that point, was not looking so positive for 2024 and the following years.

Finally, IFI warned that the path adopted previously, of continuous modifications to loosen the requirements of the fiscal rules when the government is faced with difficulties in balancing the public accounts, could lead the Sustainable Fiscal Regime down the same path of compromising the credibility experienced by previous rules.

Although economic growth has proved to be a positive factor and should end the year above initial expectations[24], due to the design of indexing mandatory spending to revenue, which has a positive correlation with GDP, there has been a continuous increase in spending on health, education, and parliamentary amendments, as expected.

Inflation will also end the period above initial forecasts, contributing, along with the increase in GDP, to the rise in the minimum wage in the following years. This ended up putting pressure, directly or indirectly, on the growth of wage, social security, and welfare spending. The rise in the Selic[25] rate, in response to rising inflation, also helps to put pressure on the growth of public debt.

Even the strong performance of the labor market, which has also been positively surprising due to the low unemployment rate, may be one of the factors responsible for the increase in worker turnover. Given the design of labor benefits[26], the policy ends up generating rising expenses even in the face of favorable employment indicators.

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[21] Available at: https://tinyurl.com/2jhfm23s.
[22] Available at: https://tinyurl.com/ye88v28n.
[23] Available at: https://tinyurl.com/anv68sfz.
[24] Available at: https://tinyurl.com/yc3m9zcu.
[25] Available at: https://tinyurl.com/bdhtkcvp.
[26] Available at: https://tinyurl.com/n7jer96x.

Given that the scenario of growing pressure on the conduct of fiscal policy was expected and foreseeable, the major question at the beginning of this year was what the government's response would be and how potential adversities, should they materialize, would be addressed.

Four structural measures leading to a permanent increase in expenditures are compromising the fiscal framework

As outlined in the aforementioned RAF No. 84, Transitional Constitutional Amendment (EC) No. 126 of December 21, 2022[14], indicated an expansion of the primary deficit from 0.6% to 2.4% of the Gross Domestic Product (GDP). This corresponds to an increase from BRL65.9 billion, according to the 2023 Budget Directives Bill (PLDO)[15], to BRL228.1 billion, of which BRL168.2 billion was an additional deficit lacking an identified funding source[16].

However, these deficits were further expanded by BRL92.4 billion over the course of 2023, due to the judgment of ADIs No. 7064 and No. 7047[17] and the release of extraordinary credit by Provisional Measure (MP) No. 1200[18] of December 20, 2023. These funds were allocated for the payment of registered warrants corresponding to liabilities generated in 2022 and 2023 and the advance of the amount planned for 2024.

At the end of 2023, the Federal Government had a primary deficit of BRL265.2 billion, BRL30.1 billion less than the adjusted program[19] (which refers to the deficit forecast by Decree No. 11811/2023[20], of BRL202.9 billion, plus the deduction of registered warrants, of BRL92.4 billion, totaling BRL295.3 billion).

In addition to the one-off impact on fiscal results in 2023, the Transition EC mainly allowed[21] the maintenance of the benefits paid by the Bolsa Família Program at the levels observed during the Covid-19 pandemic (a minimum benefit of BRL600.00) which, in theory, would have been reduced to a minimum of BRL400.00 by the end of the pandemic.

However, these benefits increased, in real terms of 2024, from BRL43.8 billion in 2019, the last year before the pandemic, to BRL173.9 billion in 2023, and are expected to remain at this level in the coming years. It should be noted that the Annual Budget Bill (PLOA) for 2023[35] foresaw the disbursement of BRL106.5 billion with the Brazil Aid Program, but in nominal terms BRL166.3 billion was spent in the year.

This **first measure** represents a permanent increase of BRL59.8 billion per year in real terms. Thus, **the medium-term fiscal impact (10 years) of the permanent increase in spending on the Bolsa Família Program is BRL598 billion**, without any measures being presented to compensate for this through a permanent increase in revenue or a permanent reduction in other budget spending.

Finally, the Transition EC determined that the President of the Republic should submit to the National Congress, by August 31, 2023, a supplementary bill with the aim of instituting a new fiscal regime that is "sustainable in order to guarantee the country's macroeconomic stability and create the appropriate conditions for socioeconomic growth" (EC No. 126/2022, art. 6).

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[27] Available at: https://www.planalto.gov.br/ccivil_03/constituicao/emendas/emc/emc126.htm.
[28] Available at: https://tinyurl.com/cnjv3fbc.
[29] Available at: https://tinyurl.com/2sf4ee24.
[30] Available at: https://tinyurl.com/yex2hucb.
[31] Available at: https://tinyurl.com/mpp6dp8h.
[32] Of this difference, BRL26.3 billion resulted from a lower primary deficit for the central government, while BRL3.8 billion was due to a lower deficit for federal state-owned enterprises.
[33] Available at: https://tinyurl.com/d6ffyyar.
[34] See, for example: https://tinyurl.com/yc2k8654.
[35] See, for example: https://tinyurl.com/4zea6p2u.

As previously commented by IFI, the entry into force of Supplementary Law (LC) No. 200[22], of August 30, 2023, which established the Sustainable Fiscal Regime, reinstated the linkage of constitutional minimums for health and education to the performance of Net Current Revenue (RCL) and Net Tax Revenue (RLI), respectively. This has had a direct impact on the growth trajectory of these primary expenditures.

In RAF No. 91[23], of August 2024, IFI calculated the fiscal cost of the measure that brought back the indexation of expenditures tied to the constitutional minimums for health and education. These expenditures accounted for 10% of the central government's primary spending in 2023. The exercise was carried out based on the macroeconomic and fiscal parameters outlined in IFI's medium-term projections published in RAF No. 89[38] of June 2024.

Depending on the scenario adopted–baseline, pessimistic or optimistic–IFI's projections for the **medium-term fiscal impact of this second measure**, which impacts the minimum spending floors for **health and education**, are **BRL459 billion, BRL574 billion, and BRL478 billion**, respectively.

The policy of permanently increasing the minimum wage, instituted by Law No. 14663[39], of August 28, 2023, influences the rate of growth of social security and welfare benefits, salary bonuses, and unemployment benefit, which accounted for 50% of the central government's primary expenditures in 2023.

In the aforementioned RAF No. 91, IFI calculated **the medium-term fiscal impact of this third measure**, which impacts the **minimum wage**. Depending on the scenarios, the impact **varies from BRL1.2 trillion, BRL1.4 trillion and BRL835 billion**, respectively, for the baseline, optimistic, and pessimistic scenarios.

Finally, **the fourth relevant measure** for the persistent increase in spending in the medium term was the creation of the National
Fund for Regional Development (FNDR) and the Compensation Fund for Fiscal or Financial-Fiscal Benefits (FCBF). These funds were created following the enactment of EC No. 132[24] of December 20, 2023, which approved the tax reform on consumption.

IFI assessed the long-term fiscal impact (20 years) of the measure to create these funds in Technical Note No. 53[25] of December 7, 2023. The impact between 2029 and 2034 (the end of the medium-term horizon) is **BRL336.9 billion**, at 2024 prices[26].

Thus, **the medium-term fiscal impact of these four measures**, approved between December 2022 and December 2023, **could vary between BRL2.6 trillion, BRL3.0 trillion, and BRL2.3 trillion over ten years**, respectively, in the baseline, optimistic, and pessimistic scenarios. It should be noted that these estimates do not incorporate[43] the growth in spending on parliamentary amendments, which are once again indexed to the increase in the RCL, as provided for in the RFS.

It is also important to note that the budget proposal for 2023 was already unbalanced and predicted, before all these measures were adopted, a primary deficit of BRL63.7 billion. In addition, there were already additional pressures on future primary expenditure, mainly due to the increase in the federal government's supplement to FUNDEB (until 2026) and the end of the impoundment of registered warrants payments (in 2027).

Therefore, there was an expectation among economic agents that adjustments in fiscal policy were necessary to reverse the pattern of consecutive fiscal deficits, which had pressured the trajectory of public debt for eight consecutive years (between 2014 and 2021), with a one-off reversal in 2022, and the projection of continuous future deficits.

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[36] Available at: https://tinyurl.com/4n87f5my.
[37] Available at: https://tinyurl.com/4vpysryk.
[38] Available at: https://tinyurl.com/52zwfrrv.
[39] Available at: https://tinyurl.com/2fbupztb.
[40] Available at: https://tinyurl.com/bxptzn22.
[41] Available at: https://tinyurl.com/5yd2f7pt.
[42] The amount of BRL322 billion, adjusted to 2023 constant values, was updated by the IPCA closed in 2023, equivalent to 4.62%.
[43] As already discussed in the aforementioned RAF No. 91, of August 2024.

However, even in the face of an adverse scenario regarding the balance of public accounts, the decision was made to adopt permanent measures[27] to increase primary expenditures, thereby increasing the pressure to achieve fiscal results that would allow for a sustainable trajectory of the relationship between General Government Gross Debt (GBGD) and Gross Domestic Product (GDP), as outlined in the RFS (Supplementary Law No. 200/2023, art. 2).

Delay in controlling expenditures, promises, and heterodox measures do not anchor expectations

Given the choice to increase public spending, the question that arose from the outset of the RFS's implementation was that it would be necessary to implement a review process of expenditures[28], in order to make room within the fiscal framework's expenditure limit to accommodate, albeit temporarily, the already contracted growth of mandatory spending.

In addition, given the rigidity of the budget and the historical difficulty of consistently reducing spending in Brazil, it would also be necessary to make a fiscal effort on the revenue side, in order to restore the fiscal base[29]. This measure would also be important for achieving primary surplus targets compatible with debt sustainability.

However, there was a mismatch between the implementation of the two agendas. The effort to rebuild the tax base was successful, delivering enough revenue to help meet the primary surplus target in 2023 and possibly in 2024, although less than projected in the respective Annual Budget Laws (LOA). The spending review agenda, on the other hand, did not achieve any significant results, given that spending continues to grow beyond what was forecast in the LOA and at a rate that is incompatible with the growth of the spending limit.

On the expenditure side, the target was reached in 2023 with the help of the legal deductions provided for in the LDO, amounting to BRL241.3 billion[30]. It may also be met in 2024, considering the deductions for expenses related to the public calamity in Rio Grande do Sul (BRL19.9 billion so far, potentially reaching BRL24.6 billion[31]), the TCU-Plenary Appellate Decision 1103/2024[32] (BRL1.2 billion), and the lower limit of the fiscal target set by the LDO (BRL28.8 billion).

Another factor that could help meet the target this year would be the continued suspension of the implementation of mandatory parliamentary amendments until new transparency rules are in place[33]. So far[34], of the BRL49.1 billion in the current budget, BRL23.3 billion has been paid, leaving BRL25.8 billion to be paid. Supplementary Bill No. 175/2024, which regulates budget amendments, was sent for presidential sanction on November 19[35].

It should be stressed that meeting the primary result targets is necessary, but may not be enough to stabilize debt growth, especially when the lower bound of the target tolerance band and the legal deductions provided for in the LDO or administrative decisions from the Federal Court of Accounts (TCU), or judicial decisions from the Supreme Court (STF), are used.

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[44] The Compensation Fund for Fiscal or Financial-Fiscal Benefits (FCBF) is temporary, and is expected to operate between 2029 and 2032. However, the National Fund for Regional Development (FNDR) is permanent and its growth in real terms until 2043, when it will reach BRL60 billion at constant 2023 values, will outweigh the positive impact caused by the end of the FCBF.

[45] See: https://tinyurl.com/4nm382w6.

[46] See: https://tinyurl.com/3mru5y9a.

[47] Available at: https://tinyurl.com/yusepxbc.

[48] Accessed on 11/19/2024. See: https://tinyurl.com/5n7htvsj.

[49] Available at: https://tinyurl.com/48ap7vxe.

[50] Available at: https://tinyurl.com/5fjjs9zy.

[51] According to the amendments panel. Available at: https://tinyurl.com/5n7htvsj.

[52] Available at: https://tinyurl.com/4ex2utuk.

The recurrent use of deductions for meeting zero primary result targets, or slightly surplus targets, can be interpreted as an attempt to avoid recognizing that deficit targets are being achieved, even temporarily. In this scenario, the center of the target established in the LDO can lead to a loss of credibility as an indicator of the direction of fiscal policy.

In addition to the low level of implementation of effective measures to control budget spending and the reduction of amounts that are relevant to achieving fiscal targets, a series of decisions announced or approved since the transition of government can be interpreted by economic agents as measures or attempts to loosen fiscal rules or bypass budgetary rigidity, contributing to the worsening of expectations.

In this context, the following can be mentioned, for example:

- The aforementioned Transitional Constitutional Amendment (EC No. 126/2022) introduced the sole paragraph of art. 121 of the Transitional Constitutional Provisions Act (ADCT), which allowed the government to appropriate, as primary revenue, the balance of undrawn PIS/PASEP funds to the National Treasury in the amount of BRL26 billion in 2023. As explained in a press release, in October 2023[36], the Central Bank (BACEN), in compliance with the Fiscal Statistics Manual, considered the appropriation as a patrimonial adjustment in the official statistics below the line, generating a discrepancy with the figures calculated by the government;
- It is worth noting that the same approach was used within the scope of Bill No. 1847/2024, transformed into Law No. 14973/2024[37], addressing the gradual end of the payroll tax exemption. Technical Note 461/2024-BCB/DSTAT[38], issued by BACEN during the processing of the matter in the Chamber of Deputies, considers that the measures for appropriating forgotten resources as primary revenue are also in disagreement with the methodology of fiscal statistics and recommended the complete rejection of Paragraph 2 of art. 45 of the legislative proposal, a measure that was not observed. Thus, a new divergence is expected between the accounting above and below the line, which could even jeopardize the achievement of the fiscal target in 2024;
- When submitting Supplementary Bill No. 93/2023[56], which would give rise to LC No. 200 that created the RFS, the government proposed changing the budget freeze rule to make it optional. The National Congress adopted a certain flexibilization by establishing a minimum level of discretionary spending necessary for the regular functioning of the public administration, using the parameter of 75% of the amount authorized in the respective LOA. However, further flexibilization in the 2024 LDO (art. 71, Paragraph 18, Item II), repeated in the 2025 PLDO (art. 68, Paragraph 17, Item II) created an indiscriminate amount of freezable allocations, resulting in an even smaller required budget freeze. When consulted about the divergence between the rules, the TCU has yet to comment;
- Still in relation to LC No. 200/2023, it should be added that the President of the Republic vetoed the change made to art. 4, Paragraph 7, of the LRF, introduced by art. 11 of the RFS, which prohibited the LDO from providing for the exclusion of any primary expenditure from the calculation of the primary result target of the fiscal and social security budgets. The veto was later overturned[39] by Congress;

[53] Available at: https://tinyurl.com/2vyzchu4.
[54] Available at: https://tinyurl.com/48mka4ua.
[55] Available at: https://tinyurl.com/yc77ka9y.
[56] Available at: https://tinyurl.com/yfesjwtw.
[57] Available at: https://tinyurl.com/2vwf93a9.

- On the occasion of the judgment of Direct Actions for Unconstitutionality (ADI) No. 7047-DF and 7064-DF, which address the partial declaration of unconstitutionality of Constitutional Amendments No. 113/21 and No. 114/21, which established a spending limit for the payment of registered warrants until 2027, the government requested[40] that the STF provide differentiated treatment for the payment of principal, which would continue to be treated as primary expenditure, and interests, which would be accounted for as financial expenditure. According to the STF's[41] decision, such a measure would contrast with international standards and harm the credibility of Brazil's fiscal statistics system. Additionally, it could create perverse incentives for the state's fiscal management, by rewarding actions that lead to the postponement or judicialization of expenditures;
- In both the 2024 LDO[42] (Law No. 14791, of December 29, 2023, art. 3, Paragraph 1, Item III) and the 2025 PLDO (Bill No. 3/2024, art. 3, Paragraph 1, Item III), expenses from the Investment Budget allocated to the New Growth Acceleration Program (PAC), limited to BRL 5 billion, were excluded from the primary deficit targets of the Global Expenditure Program (PDG), that is, from the state-owned enterprises' budget. As Paragraph 2 of the same article of the budget guidelines laws allows for compensation between the targets set for the Fiscal and Social Security Budgets and for the PDG, another source of reduction for the fiscal target was created;
- It should also be remembered that, when submitting the 2025 PLDO, the government reduced the primary surplus targets[43] for 2025 to zero, for 2026 to 0.25% of GDP, and for 2027 to 0.5% of GDP, compared to the previous targets of a fiscal surplus of 0.5% of GDP in 2025 and 1% of GDP in 2026;
- On October 3, 2024, Presidential Message No. 1210 was sent, [44]amending the 2025 PLDO and National Congress Bill of Law (PLN) No. 31[45] to amend the 2024 LDO. The objective was to make expenses[46] of dependent state-owned companies more flexible. These companies would continue to receive subsidies from the National Treasury for costing expenses but would have their own revenues and expenditures executed outside the budgetary rules;
- Another controversial measure is the use of the lower limit of the primary result target as an indicator of the need to limit commitments and financial movements. This represents abandoning the center of the target as a guiding measure for implementing budgetary freezes. The justification would be compliance with Paragraph 10 of Article 165 of the Federal Constitution, introduced by EC No. 100/2019[47], which determines that the administration must execute budgetary programs, adopting the necessary means and measures to ensure the effective delivery of goods and services to society (establishing budgetary enforceability). Although the TCU has issued a warning[48], there is still no definitive decision on the matter; and
- Finally, there was a withdrawal of public policies, which would normally be financed with budgetary resources, to be implemented through parafiscal mechanisms, such as the Pé-de-Meia Program and the Gas Aid Program. Thus, the financial surplus of public funds is reallocated by law to other funds managed by official financial institutions, which carry out the expenses related to public policies outside the budget. The alternative use of these resources could be to reduce public debt, as happened in 2021, when BRL140.9 billion[49] were used for this purpose.

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[58] Available at: https://tinyurl.com/yc8f97y9.
[59] Available at: https://tinyurl.com/2se3vx7x.
[60] Available at: https://tinyurl.com/4cujc9dj.
[61] Available at: https://tinyurl.com/mr2uzxfd.
[62] Available at: https://tinyurl.com/382mt732.
[63] Available at: https://tinyurl.com/54r7x33c.
[64] See, for example: https://tinyurl.com/53ppk7er.
[65] Available at: https://tinyurl.com/mwjr45x2.
[66] Available at: https://tinyurl.com/tu6k5632.
[67] Available at: https://tinyurl.com/4xw2fs4a.

In light of the deterioration in expectations, the government's response has repeatedly been to announce[50] the implementation of a robust package of expenditure reviews. However, a decision on the size and scope of the measures is still expected to be made in November[51].

Conclusion

Constant announcements of spending review measures with low implementation, accompanied by increases in revenues, which are generally cyclical, as well as the adoption of measures that can bypass budgetary and fiscal rules, and the use of discounts to achieve fiscal targets, are contributing to the scenario of loss of anchoring of medium-term expectations.

The magnitude of the fiscal expansion caused by the four measures adopted during the transition and in the first year of the current government (with an estimated cost of between BRL2.3 trillion and BRL3 trillion over ten years), and the rigidity of the budget, form the perception that short-term measures will not be enough to reverse the unsustainability of the fiscal framework's spending limit, and may at most postpone the need to change the regulations in the medium term.

If the spending review measures to be announced are merely short-term, aimed only to comply with the spending limit of the fiscal framework until the end of the current government, it is possible that expectations will not be reversed and that the conduct of fiscal policy will continue to guide the economic debate, maintaining pressure mainly on exchange and interest rates, with a growing impact on public indebtedness.

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[68] See, for example: https://tinyurl.com/5premfn5.
[69] See, for example: https://tinyurl.com/556x57dw.

IFI projections

SHORT TERM

IFI projections	2024			2025		
	Oct/24	Nov/24	Comparison	Oct/24	Nov/24	Comparison
GDP – real growth (% p.a.)	2.81	2.81	=	1.80	1.80	=
GDP – nominal (BRL billion)	11,578.66	11,578.66	=	12,249.07	12,249.07	=
IPCA – accumulated (% in the year)	4.42	4.42	=	3.66	3.66	=
Exchange rate - end of period (BRL/US$)	5.40	5.40	=	5.47	5.47	=
Employment - growth (%)	2.50	2.50	=	1.20	1.20	=
Payroll - growth (%)	7.01	7.01	=	2.41	2.41	=
Selic – end of period (% p.a.)	11.50	11.50	=	10.00	10.00	=
Ex-ante real interest rate (% p.a.)	6.17	6.17	=	5.48	5.48	=
Consolidated Public Sector Primary Balance (% of GDP)	-0.83	-0.83	=	-1.10	-1.10	=
of which Central Government	-0.83	-0.83	=	-1.20	-1.20	=
Net Nominal Interest (% of GDP)	8.08	8.08	=	7.48	7.48	=
Nominal Balance (% of GDP)	-8.90	-8.90	=	-8.58	-8.58	=
General Government Gross Debt (% of GDP)	80.01	80.01	=	82.21	82.21	=

SENADO FEDERAL

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