

Fiscal Follow-Up Report

N° 116

September 17th 2026

FEDERAL SENATE

President of the Federal Senate

Senator Davi Alcolumbre (União-AP)

INDEPENDENT FISCAL INSTITUTION

Executive Director

Marcus Vinícius Caetano Pestana da Silva

Director

Alexandre Augusto Seijas de Andrade

Analysts

Dalmo Jorge Lima Palmeira

Gustavo Marciel de Queiroz

Lucas Vinícius Penha Martins Bomfim Leal

Rafael da Rocha Mendonça Bacciotti

Rafael Luis Comini Curi

Public relations executive

Carmensita Corso

Interns

Lukas Cortez de Medeiros Balogh Fagundes

Tallita Soares de Andrade

Executive Secretary

Thuane Vieira Rocha

Report Layout

CODIV/SECOM e SEFPRO/SEGRAF

Budgetary Uncertainties, Interest Rate Drivers, and Court-Ordered Debt Payments

The Independent Fiscal Institution (IFI) releases, in September, the 116th Fiscal Follow-up Report (RAF, kept here in its original acronym, as are the acronyms of other Brazilian institutions, programs, and indicators). Fiscal policy has occupied significant space in the current presidential succession debate. There is growing awareness in society of budgetary rigidity, the limited room for essential investments, the deleterious effects of the fiscal imbalance, and its implications for the tax burden and the interest rate.

To inform this discussion, RAF 116 seeks to provide an X-ray of the Annual Budget Bill (PLOA 2027), submitted by the government to the National Congress on August 31. Within its legal mandate, the IFI presents alternative projections, making its assumptions and parameters explicit. Divergences from the figures presented in the PLOA 2027 are already apparent with respect to the projection of the actual primary balance to be achieved next year. The budget proposal forecasts a primary surplus of BRL 18.6 billion. The IFI forecasts a primary deficit of BRL 86.1 billion. A significant difference of BRL 104.8 billion.

Where does the divergence lie? First, in the macroeconomic parameters. The PLOA 2027 is based on a projected GDP expansion of 2.5%. The IFI projects 1.8% growth, and the Focus Report projects 1.5%. These projections have profound implications for public revenue because more or less economic growth means more or fewer resources are available to fund government operations and public policies. Another important variable in shaping the budget structure is inflation. In the PLOA 2027, the government estimates an IPCA of 3.6% for next year. The IFI projects 4.0%, and the Focus Report projects 4.3%. Regarding the projection of the wage bill, which is an important factor in calculating social security revenue, the government used a growth parameter of 10.1%, while the IFI uses an expansion parameter of 7.3%.

In the expenditure projections, there are discrepancies in the estimates for social security spending, as well as for the BPC, salary allowance, unemployment benefit, and court rulings. The IFI believes the figures in the budget proposal are relatively optimistic. For its part, the government is counting on its spending review strategy.

These discrepancies affect the very outlook for compliance with the targets set under the fiscal framework. Even after applying the legal exclusions to expenditures when calculating the primary balance, the IFI identifies that the primary surplus will be less than BRL 1 billion. This amount is insufficient to meet the fiscal target, even at the lower bound of the 0.25 p.p. of GDP tolerance band. The IFI therefore points to the need for spending cuts of BRL 35.7 billion to meet the target next year. However, this does not account for the new expenditure of BRL 33.8 billion related to the contribution to the Compensation Fund for States, which was created to offset the replacement of the IPI by the Selective Tax and was provided for under the tax reform. Although this expenditure is not counted under the expenditure ceiling, it affects compliance with the primary balance target.

An additional source of uncertainty is the BRL 42 billion in revenue included in the PLOA 2027 as a contingent revenue source, related to the Selective Tax, which is to be created by a specific ordinary law whose bill has not even been sent to the National Congress.

With regard to revenue derived from the exploitation of natural resources and dividends passed on to the National Treasury by state-owned enterprises, the IFI's figures are more optimistic than those presented in the PLOA 2027, owing to the average oil barrel price considered. As for constitutional revenue-sharing transfers to states and municipalities, there is another sharp divergence. The government estimates, in the PLOA 2027, that transfers will fall from the current 4.7% of GDP, according to the 3rd RARDP of 2026, to 4.1% of GDP. In the PLDO 2027, presented last April, the government's projection was for a transfer amount equivalent to 4.4% of GDP next year.

Recently introduced legal changes have generated savings. For example, Complementary Law (LC) No. 235 of 2026 removed revenue derived from oil and gas sales from the Net Current Revenue (RCL) calculation basis. This affected the health spending floor and the Federal District Constitutional Fund. Another adjustment was the inclusion of the Pé-de-Meia Program in the education spending floor.

The IFI believes that the fiscal target can be met in 2027 if the current macroeconomic assumptions are confirmed and budgetary adjustments are made through necessary spending cuts. Nevertheless, the fiscal result will still be far from what is needed to stabilize the ratio of public debt to GDP.

And precisely in order to address the relationship between the primary and nominal balances, the fiscal situation and the interest rate, and their implications for the profile and dynamics of public debt, the IFI offers, in RAF 116, a topic devoted to this subject. The debate over the high level of real interest rates in Brazil has been central to the economic agenda. The study presented here breaks down the role of expectations and the risk premium as a driver of volatility. It analyzes the recent growth of Selic-linked securities in the composition of Brazilian public debt, which heightens the impact of monetary policy on its cost and may reinforce the interaction between interest rates and fiscal dynamics.

The analysis shows that, although monetary, inflationary, and external factors are relevant, the fiscal situation is the central determinant in setting the risk premium demanded by buyers of Brazilian securities, particularly long-term securities. The persistence of high interest rates cannot be attributed solely to the conduct of monetary policy, since the risk premium accounts for most of the volatility and is significantly associated with the country's fiscal position. We remain trapped in a vicious circle involving fiscal imbalance and high interest rates, which feed on each other. The study concludes: "Thus, a sustained reduction in the cost of financing the Brazilian economy requires that the fiscal dimension be explicitly incorporated into the debate on high interest rates."

Lastly, RAF 116 includes a topic with a historical analysis of expenditures on court-ordered debt payments (*precatórios*), spending arising from judicial rulings, which have become a growing source of pressure on the federal budget. The study shows that, starting in 2022, this expenditure began operating at a new level, well above the previously observed average, and that the successive Constitutional Amendments enacted to regulate the matter – some of which were revised by the Federal Supreme Court – have failed to contain this growth. Although the volume of payments has increased significantly, the stock of court-ordered debt payments continues to grow, indicating that the root of the problem lies in the accelerated issuance of new court-ordered debt payments, rather than in delays in paying existing ones. The text also warns that the appropriation provided for in the PLOA 2027 for this expenditure is lower than the current 2026 appropriation, which may prove insufficient given the recent trajectory.

We hope you find this report useful.

Marcus Pestana
Executive Director of the IFI
Alexandre Andrade
Director of the IFI

Highlights

The 2027 Budget Bill and the Risk of Missing the Fiscal Target According to IFI Estimates

The assessment of the 2027 Budget Bill (PLOA 2027) shows a divergence of BRL 104.8 billion between the actual primary balance projected by the Executive Branch (a surplus of BRL 18.6 billion) and by the IFI (a deficit of BRL 86.1 billion), stemming from more optimistic macroeconomic assumptions and greater confidence in the measures to review social security and BPC spending. While the PLOA projects a recorded surplus of BRL 83.4 billion – a margin of BRL 10.1 billion above the center of the target – the IFI's scenario points to a surplus of BRL 0.9 billion, insufficient to reach the lower bound of the tolerance band, requiring additional spending cuts of BRL 35.7 billion for formal compliance with the target. The analysis also highlights the introduction of the BRL 33.8 billion contribution to the Compensation Fund for States for the replacement of the IPI by the Selective Tax, a new expenditure counted toward the fiscal target, and reinforces the diagnosis of growing budgetary rigidity, with mandatory expenditures subject to the LC No. 200 limit increasing by BRL 131.4 billion between 2026 and 2027. **(Page 6)**

Risk Premium and Fiscal Policy in Brazil

Brazil's real interest rate remains persistently higher than that observed in peer countries. Decomposing the five-year nominal rate – using the methodology of Adrian, Crump, and Moench (2013) – into Selic expectations and the risk premium, this note shows that it is the premium, not the expectation, that accounts for most of the volatility in the long rate, and that it responds in a statistically significant way to the fiscal position (DBGG). This sensitivity increases with the maturity of the security, concentrating at the 5- and 10-year tenors, with the estimated contribution of the General Government Gross Debt (DBGG) to the premium rising from 2.10 p.p. (2011–2013) to 3.16 p.p. over the twelve months through August – a level higher than that recorded during the 2014–2016 fiscal crisis. Added to this is the change in the composition of public debt, with Selic-linked securities jumping from 35.7% of the Federal Public Debt stock (December 2023) to 46.4% (July 2026), which amplifies the transmission of monetary policy to the cost of debt. Monetary, inflationary, and external factors remain relevant, but the fiscal position is a statistically significant and economically meaningful determinant of the risk premium – especially at longer horizons. **(Page 27)**

Court-Ordered Debt Payments in the Federal Budget

Court-ordered debt payments have become a growing source of pressure on the federal budget. The issue has prompted three constitutional amendments and three direct actions for the declaration of unconstitutionality (ADIs) before the Federal Supreme Court over the past five years. However, the problem remains unresolved. The text analyzes this trajectory and finds that, starting in 2022, the expenditure underwent a structural shift to a new level, rising from around 0.6% to 0.7% of GDP. It concludes that this growth stems from the acceleration in the issuance of new court-ordered debt payments, not necessarily from payment delays, driven mainly by the "Other" and Social Security aggregates. **(Page 44)**

First published on: September 17, 2026

File updated on: September 17, 2026

See errata at: <https://www12.senado.leg.br/ifi/publicacoes-1/relatorio/2026/setembro/erratas>

The 2027 Budget Bill and the Risk of Missing the Fiscal Target According to IFI Estimates

Alexandre Andrade and Rafael Bacciotti

Introductory Remarks

This analysis seeks to assess the original version of the Annual Budget Bill (PLOA) for 2027¹, submitted by the Executive Branch for review by the National Congress on August 31. As a basis for comparison, the most recent medium-term fiscal scenario published by the IFI, in June of this year, will be considered².

According to the Budget Guidelines Bill (PLDO 2027)³, the primary balance target set for fiscal year 2027 is a surplus of BRL 73.2 billion (0.5% of GDP), with a lower bound of the tolerance band of BRL 36.6 billion (0.25% of GDP).

In RAF No. 113, of June 2026, the IFI projected an actual primary deficit of BRL 86.1 billion (0.6% of GDP) for the central government in 2027. Once the legal deductions of expenditures are excluded from the calculation of the target, there would be a primary surplus of BRL 0.9 billion (0.01% of GDP) next year. It would therefore be possible to formally comply with the primary surplus fiscal target set for 2027 through spending cuts to non-rigid discretionary expenditures of BRL 35.7 billion.

According to the Executive Branch's estimates, disclosed in next year's budget proposal, the central government is expected to post an actual primary surplus of BRL 18.6 billion (0.1% of GDP). Excluding the legal deductions of expenditures, the primary surplus would rise to BRL 83.4 billion (0.6% of GDP) in 2027.

The assessment of the PLOA 2027 indicates that there are risks to compliance with the primary balance target set in the PLDO 2027. As will be explored further below, there is a possibility of revenue shortfalls if economic growth comes in below the 2.5% projected in the budget proposal. On the expenditure side, the inflation parameters and the assumptions used for the behavior of certain mandatory expenditure aggregates — such as periodic spending reviews in the payment of social security benefits and the Continuous Cash Benefit (BPC) — may not materialize into the estimated savings. In addition, the introduction,

¹ Documents available at: <https://www.gov.br/planejamento/pt-br/assuntos/orcamento/orcamentos-anuais/2027/ploa-2027> e <https://www.congressonacional.leg.br/web/orcamento/acompanhe/orcamento-anual/-/loa/2027>.

² The IFI's most recent review of macroeconomic and fiscal scenarios is presented in Fiscal Follow-up Report (RAF) No. 113, of June 2026. Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/935942/RAF113_JUN2026.pdf.

³ The PLDO 2027 documents are available at: <https://www.gov.br/planejamento/pt-br/assuntos/orcamento/orcamentos-anuais/2027/pldo>. The IFI analyzed the bill in RAF No. 112, of May 2026, available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/865129/RAF112_MAI2026.pdf.

in the PLOA 2027, of the contribution to the Compensation Fund for States for the replacement of the IPI by the Selective Tax – not incorporated into the IFI's projections in RAF No. 113 – illustrates how the very design of the tax reform transition can generate new primary expenditures that are relevant to the calculation of the fiscal target.

The remainder of this text is organized as follows: the next section compares the macroeconomic parameters of the PLOA 2027 with the IFI's scenario and with the Focus Report; the following sections detail the primary revenue and expenditure projections, the calculation of the LC No. 200 expenditure limit and, finally, the breakdown of the primary balance and the legal deductions that make up the recorded balance for target compliance purposes.

Comparison Between the Macroeconomic Parameters of the PLOA 2027 and RAF No. 113

This section compares the main macroeconomic assumptions of the PLOA 2027 with the IFI's most recent scenario, published in RAF No. 113, of June 2026, and with the medians from the Focus Report. These assumptions influence revenue and expenditure projections, as well as fiscal indicators expressed as a share of GDP. Table 1 summarizes the parameters for 2027.

TABLE 1. PROJECTIONS FOR SELECTED MACROECONOMIC VARIABLES – 2027

Variable	PLOA 2027	IFI – RAF No. 113	Focus
GDP – real growth (% p.a.)	2.5	1.8	1.5
Nominal GDP (BRL billions)	14,782.9	14,533.4	-
IPCA – year-to-date (%)	3.6	4.0	4.3
INPC – year-to-date (%)	3.7	3.8	-
Selic – end of period (% p.a.)	12.0	12.0	12.0
Exchange rate – end of period (BRL/USD)	5.3	5.2	5.3
Nominal wage bill (% var.)	10.1	7.3	-
Average price of Brent crude oil (USD/barrel)	71.0	75.0	-

Sources: SPE/MF Macroeconomic Parameters Framework, of July 2026; PLOA 2027 Presidential Message; IFI; Focus Report of September 4 (Central Bank). Prepared by: IFI. In the PLOA, the projection refers to the wage bill of formally employed workers. In the IFI, it corresponds to the income of the entire employed population, as measured by the Continuous National Household Sample Survey (PNADc). The figures are not directly comparable.

For 2027, the PLOA projects real GDP growth of 2.5%, above the IFI's projection of 1.8% and the median of the Focus Report, of 1.5%. Compared with 2026, the trajectories also differ. The official scenario assumes a slight acceleration, from 2.3% to 2.5%, while the IFI and the Focus Report project a deceleration, from 2.0% to 1.8% and from 1.9% to 1.5%, respectively.

The Executive Branch's projection for 2027 corresponds to an expansion close to the economy's potential growth. According to the Presidential Message accompanying the PLOA, this performance would be sustained by the gradual reduction of real interest rates and by the lagged effects of monetary easing on credit, consumption, and investment.

Available data for 2026 show a moderation in growth at the margin. On a seasonally adjusted, quarter-on-quarter basis, GDP grew 0.5% in the second quarter, following growth of 1.1% in the first, with household consumption declining and domestic demand losing momentum. Maintaining restrictive monetary conditions, allocating a larger share of income to debt servicing, and expecting a smaller contribution from agriculture and income and credit support measures may limit expansion in the coming quarters. In this context, data released after RAF No. 113 was published suggest a downside bias for the 1.8% growth projection presented by the Independent Fiscal Institution in June.

In the IFI's scenario, projected growth for 2027 remains below potential, estimated at 2.3%. The reduction in the Selic rate from 14.0% p.a. at the end of 2026 to 12.0% p.a. at the end of 2027, and in the ex ante real interest rate, from 7.5% p.a. to 5.4% p.a., gradually eases the monetary restriction and helps sustain economic activity. The IFI expects growth to return to its potential pace from 2028 onward, supported by moderate productivity gains and a gradual increase in the investment rate.

The result for the second quarter left a statistical carryover of approximately 1.8% for annual growth in 2026. This figure does not represent a projection, but rather the growth that would be recorded for the year if GDP remained, in the second half, at the same level observed in the second quarter. Under this hypothesis, the statistical carryover for 2027 would be approximately 0.1%. In this sense, the carryover contribution inherited from 2026 to annual growth in 2027 would be reduced. Therefore, the projections from the PLOA, the IFI, and the Focus Report would depend primarily on the expansion of economic activity in the coming year.

Beyond real growth, the scenarios also diverge regarding the price developments embedded in nominal GDP. The PLOA estimates nominal GDP of BRL 14,782.9 billion in 2027, BRL 249.5 billion above the BRL 14,533.4 billion projected by the IFI. This difference reflects both the higher real growth projected by the Executive Branch and the higher variation projected for the implicit GDP deflator, of 5.4%, compared with 4.5% in the IFI's scenario. For comparison, the median of the projections from the Prisma Fiscal survey, of August 2026, for the deflator variation in 2027 was 4.9%, 0.5 p.p. below the PLOA's assumption.

In the PLOA's scenario, the variation in the implicit GDP deflator, of 5.4%, exceeds the projected IPCA, of 3.6%, by 1.8 p.p. This differential is higher than the historical average, of approximately 1.3 p.p., and the 0.8 p.p. observed in the second quarter of 2026. The difference between the two indicators, in any case, does not represent an inconsistency: the IPCA tracks the prices of a household consumption basket, while the deflator covers the prices of final goods and services produced in the economy, according to the National

Accounts framework. The Presidential Message, however, does not detail the assumptions that explain the differential projected for 2027.

The PLOA's IPCA projection, of 3.6%, is also lower than the IFI's estimate, of 4.0%, and the Focus Report's, of 4.3%. The official scenario therefore assumes a faster convergence of consumer inflation toward the target.

A higher nominal GDP affects the presentation of fiscal indicators. If the nominal values of revenue, expenditure, the primary balance, or debt remain unchanged, a larger GDP mechanically reduces these indicators when expressed as a share of output.

The PLOA projects 10.1% growth in the wage bill of formally employed workers in 2027, a parameter used in projecting revenue for the General Social Security Regime (RGPS). This estimate combines increases of 3.4% in formal employment and 6.5% in nominal income and is associated with the higher activity growth scenario considered in the proposal. The IFI projects a 7.3% expansion in labor income from the Continuous PNAD, which covers both formal and informal workers. The direct comparison between the two rates is therefore limited by differences in indicator coverage.

The projections for interest and exchange rates are close. The PLOA, the IFI, and the Focus Report all project a Selic rate of 12.0% p.a. by the end of 2027. The exchange rate projections are BRL 5.28 per dollar in the PLOA, BRL 5.23 in the IFI's scenario, and BRL 5.30 in the Focus Report. Regarding Brent crude oil, the PLOA uses an average price of USD 71.03 per barrel, while the IFI uses USD 75.00.

The PLOA incorporates higher real growth and deflator variation than the IFI projects, which contributes to a higher nominal GDP. If the nominal values of the fiscal indicators remain unchanged, the larger denominator will reduce their magnitude as a share of output. The projected expansion in the formal wage bill is associated with the higher activity growth scenario and is an important assumption for social security revenue. However, direct comparison with the IFI's projection is limited due to differences in indicator coverage.

Revenue Projections

Table 2 contains the most recent revenue projections made by the Executive Branch and the IFI for 2026, the base year for the preparation of the 2027 budget. The Executive Branch's estimates are drawn from the 3rd Primary Revenue and Expenditure Assessment Report (RARDP, covering May–June)⁴, while the IFI's are taken from the already referenced RAF No. 113. In RAF No. 115⁵, of August 2026, the IFI conducted an analysis of this year's 3rd RARDP.

⁴ Available at: <https://www.tesourotransparente.gov.br/publicacoes/relatorio-de-avaliacao-de-receitas-e-despesas-primarias-rardp/2026/15>.

⁵ Available at: https://www12.senado.leg.br/ifi/pdf/raf115_ago2026.pdf.

TABLE 2. EXECUTIVE BRANCH AND IFI PROJECTIONS FOR PRIMARY REVENUE IN 2026

Variables	2026					
	3rd RARDP Assessment		IFI (RAF No.113/Jun26)		Diff. 3rd RARDP - IFI (RAF No.113)	
	BRL billions	% of GDP	BRL billions	% of GDP	BRL billions	p.p. of GDP
1. Total primary revenue	3,237.2	23.7	3,229.1	23.6	8.1	0.0
Administered revenues	2,079.8	15.2	2,096.4	15.3	-16.6	-0.1
Net collection for the RGPS	784.0	5.7	748.5	5.5	35.5	0.3
Non-administered revenues	373.4	2.7	384.2	2.8	-10.8	-0.1
2. Revenue-sharing Transfers	643.6	4.7	649.9	4.8	-6.3	-0.1
3. Net primary revenue [1-2]	2,593.6	19.0	2,579.2	18.9	14.4	0.1

Source: RARDP for the 3rd two-month period of 2026 and RAF No. 113. Prepared by: IFI.

Table 3 presents the estimates contained in the PLDO 2027, the PLOA 2027, and RAF No. 113 for 2027. According to the table, there is a difference – the largest – between the PLOA 2027 and RAF No. 113 estimates of BRL 64.2 billion (0.0 p.p. of GDP), for total primary revenue of the central government next year.

TABLE 3. EXECUTIVE BRANCH AND IFI PROJECTIONS FOR PRIMARY REVENUE IN 2027

Variables	2027							
	PLDO 2027		PLOA 2027		IFI (RAF No. 113/Jun26)		Diff. PLOA 2027 - IFI (RAF No. 113)	
	BRL billions	% of GDP	BRL billions	% of GDP	BRL billions	% of GDP	BRL billions	p.p. of GDP
1. Total primary revenue	3,408.2	23.3	3,459.3	23.4	3,395.1	23.4	64.2	0.0
Administered revenues	2,210.0	15.1	2,222.5	15.0	2,208.1	15.2	14.4	-0.2
Tax incentives	-	-	0.0	0.0	-	-	-	-
Net collection for the RGPS	879.8	6.0	875.1	5.9	808.5	5.6	66.6	0.3
Non-administered revenues	318.4	2.2	361.7	2.4	378.4	2.6	-16.8	-0.2
2. Revenue-sharing Transfers	640.0	4.4	610.6	4.1	674.3	4.6	-63.7	-0.5
3. Net primary revenue [1-2]	2,768.2	18.9	2,848.7	19.3	2,720.8	18.7	127.9	0.6

Source: PLDO 2027, PLOA 2027 and RAF No. 113. Prepared by: IFI.

The analysis of the groups that make up primary revenue indicates the following deviations between the PLOA and IFI projections: (i) BRL 14.4 billion (-0.2 p.p. of GDP), the largest, in

administered revenue; (ii) BRL 66.6 billion (0.3 p.p. of GDP), the largest, in net collection for the RGPS; and (iii) BRL 16.8 billion (-0.2 p.p. of GDP), the smallest, in non-administered revenue.

The deviations between the PLOA 2027 and IFI estimates lie mainly in the assumptions and macroeconomic parameters used. As discussed in the previous section of this text, the PLOA 2027 embeds an expected GDP increase of 2.5% next year, while the IFI considers growth of 1.8%, with a downside bias. In addition, the Executive Branch has a higher estimate for the implicit GDP deflator compared with the IFI. These discrepancies explain the divergence in the projections for administered revenue in 2027.

Both projections (IFI and government) take into account the transition rules stemming from the entry into force of the consumption tax reform, as well as the cap on tax waivers, as provided for in Article 6-A of Complementary Law (LC) No. 200⁶, of 2023. Starting in 2027, the Social Contribution on Goods and Services (CBS)⁷ will begin to be levied.

Still with regard to administered revenue, the Executive Branch estimated CBS collection of BRL 636.8 billion (4.3% of GDP) in the PLOA 2027, based on the following assumptions and methodological parameters: (i) revenue neutrality as a share of GDP, a principle followed in the design of the tax reform; (ii) use of the same tax base as the taxes being replaced (PIS and Cofins); (iii) calibration based on the 2026 testing phase, when a reduced rate of 0.1% was applied to the contribution; and (iv) full non-cumulativity and tax relief for the basic food basket.

The PLOA 2027 estimates of BRL 636.8 billion (4.3% of GDP) for the CBS and BRL 42.0 billion (0.3% of GDP) for the Selective Tax (IS)⁸, were made under conditions in which regulatory issues and final tax rates had not yet been settled. For this reason, the Executive Branch adopted transition assumptions, base-equivalence assumptions, and fiscal-neutrality assumptions.

The methodological solutions used by the government to address the lack of detailed regulation of the reform are structured around four main pillars. The first corresponds to the equivalence of tax bases. Since the collection parameters and specific details of the new taxes still depend on consolidation by the National Congress, the Executive Branch assumed that the projection bases for the CBS and the Selective Tax are exactly the same as those of the federal taxes they will replace – PIS/Cofins and the IOF on insurance, and the IPI, respectively. Accordingly, the tax reform rules were applied to the historical collection data for these taxes.

⁶ See: https://www.planalto.gov.br/ccivil_03/leis/lcp/lcp200.htm.

⁷ A tax whose collection falls under federal jurisdiction, established by Constitutional Amendment No. 132, of 2023. The contribution was designed based on a value-added tax (VAT) model and is intended to unify and replace the PIS and Cofins. In 2027, the CBS will begin to be levied in full and on a definitive basis, while the PIS and Cofins will be officially and definitively abolished.

⁸ tax that will replace the Tax on Industrialized Goods (IPI) throughout national territory, with the exception of the Manaus Free Trade Zone.

The second pillar concerns tax burden neutrality, as provided in Article 353 of LC No. 214⁹, of 2025. The PLOA 2027 estimates take into account the constitutional premise that the tax reform must be fiscally neutral. Accordingly, the projections were based on revenue from the replaced taxes, as a share of GDP, over the 2012–2021 period, to be updated once the necessary definitions become available.

The third pillar corresponds to the replacement of, and residual collections from, the discontinued taxes. The reform's transition provides for the full replacement of PIS/Cofins and the partial replacement of the IPI, by the CBS and the IS starting in 2027. Accordingly, the government projected a reduction in collection estimates for the former taxes, which now appear in the PLOA 2027 at residual amounts corresponding to collections from past taxable events. To illustrate, IPI collection is projected at BRL 5.5 billion in 2027, since the tax will continue to be levied in the Manaus Free Trade Zone. Cofins has a projected residual amount of BRL 31.8 billion, while PIS/Pasep has BRL 34.4 billion.

The fourth and final pillar of the methodological solutions for the lack of regulation on certain aspects of the tax reform concerns the classification of the Selective Tax as a contingent revenue source. LC No. 214 provides that the specific rates for this tax must be set by an ordinary law, which is still pending discussion and approval by the National Congress. In light of this pending legislation, the Executive Branch applied Article 140¹⁰ of the PLDO 2027 to classify the projection of BRL 42.0 billion for the Selective Tax as a contingent revenue source in the PLOA, when preparing the 2027 budget.

The PLOA 2027 estimates for net collection for the RGPS assume a labor market that remains warm, despite the contractionary monetary policy and the effects expected for economic activity in the coming months. The Executive Branch projects nominal wage bill growth of 10.1% in 2027. The IFI takes a more conservative view of the labor market next year, in line with the expected slowdown in economic activity. This difference in assumptions affects the social security contribution base estimated by the government in next year's budget.

Lastly, still referring to the figures in Table 3, non-administered revenue is the only group in which the IFI's estimate exceeds that of the PLOA for 2027. While the budget proposal considers non-administered revenue of BRL 361.7 billion (2.4% of GDP), the IFI estimates collection of BRL 378.4 billion (2.6% of GDP) next year, a difference of BRL 16.8 billion.

This divergence is explained mainly by the assumption for the Brent crude oil price. In the PLOA, the Executive Branch considers an average price of USD 71.0 per barrel in 2027, while the IFI considered USD 75.0 as the average for the year. This discrepancy affects two non-

⁹ Available at: https://www.planalto.gov.br/ccivil_03/leis/lcp/lcp214.htm.

¹⁰ Article 140 of the PLDO regulates the possibility for the Executive Branch to include, in the budget proposal, revenue estimates and expenditure allocations whose financial effects depend on the approval of legislative matters still under consideration.

administered revenue aggregates: the exploitation of natural resources and the collection of dividends and equity interests.

For revenue from the exploitation of natural resources, the Executive Branch estimates inflows of BRL 176.3 billion in 2027. Since around 90% of this revenue depends on oil and natural gas, the higher Brent price assumption adopted by the IFI produces higher collection from oil royalties and special participations.

The higher oil price widens Petrobras's operating margins in the exploration and production segment, increasing the company's profit potential and, consequently, the IFI's expected dividend payments to the Federal Government, relative to the estimates in the budget proposal.

In the PLOA 2027, the Executive Branch projects inflows of BRL 30.9 billion (0.2% of GDP) in dividends and equity interests, without considering advance payments or extraordinary payments by federal SOEs. The IFI estimates BRL 57.6 billion in dividend collection in 2027. This figure is part of the BRL 378.5 billion in non-administered revenue, as referenced in RAF No. 113.

Several additional points should be considered regarding the estimates in Table 3. The first concerns the projected collection of the CBS and the IS. As mentioned earlier, the projections for these two taxes, which will replace PIS/Cofins and the IPI, were made without the definitive setting of the IS rate or the CBS reference rate. Accordingly, the assumptions adopted by the Executive Branch for the collection of these taxes in 2027, which total BRL 678.8 billion (BRL 636.8 billion from the CBS and BRL 42.0 billion from the IS), may not materialize, and the actual amounts could turn out lower than those presented in the budget proposal. There is therefore a significant risk of revenue shortfalls in the PLOA 2027 projections.

The Executive Branch itself acknowledges, in the PLOA documents, that the CBS estimates are preliminary and will need to be updated as the regulatory definitions are consolidated by Congress. To address the lack of a collection history for the new tax, the government adopted the assumption of applying the CBS rules to the historical bases of the taxes being replaced or reduced (PIS, Cofins, IPI, and the IOF on insurance).

As the IFI noted in RAF No. 113, the direct and indirect effects of the tax reform on revenue collection are difficult to measure in advance, since they will require actual collection and real operational data for the final calibration of the parameters. The shift to the dual VAT model with full non-cumulatively may generate volumes of credit offsets and refunds that diverge from the simulations in the models considered by the government.

The second point worth highlighting concerns the estimates for revenue-sharing transfers. The PLOA 2027 projects BRL 610.6 billion (4.1% of GDP) in transfers to states and municipalities, while the IFI considered BRL 674.3 billion (4.6% of GDP) in RAF No. 113, of June 2026, a difference of BRL 63.7 billion.

In RAF No. 112¹¹, of May 2026, the IFI analyzed the projections presented in the PLDO 2027. In that document, a number of considerations were made regarding the trajectory the Executive Branch envisioned for revenue-sharing transfers in the coming years. The PLDO 2027 projects that transfers, as a share of GDP, will gradually decline through 2030. For 2027, the document projects transfers of 4.4% of GDP, falling to 4.3% of GDP in 2028, 4.3% of GDP in 2029, and 4.2% of GDP in 2030. In 2026, as highlighted in Table 2, the 3rd RARDP projects that transfers will reach 4.7% of GDP.

The PLOA 2027 assumes that revenue-sharing transfers will reach 4.1% of GDP in 2027, 0.3 p.p. of GDP below what was projected in the PLDO. In the aforementioned RAF No. 112, the IFI pointed out that this systematic decline in the share of federal transfers to other federative entities, relative to GDP, is inconsistent with the government's own revenue estimates presented in the PLDO 2027.

For transfers, as a share of GDP, to decline in the coming years, it would be necessary for collection of the taxes shared with states and municipalities, mainly Income Tax (IR) and IPI/IS, to fall. However, official spreadsheets from the Federal Revenue Office (RFB) indicate a constant share of IR and IPI/IS collection as a proportion of GDP through 2030.

In addition, still according to RAF No. 112, current legislation points to an expansion or maintenance of federal transfers to states and municipalities. Constitutional Amendment (EC) No. 112¹², of 2021, revised Article 159 of the Federal Constitution to gradually increase the share of IR and IPI/IS revenue allocated to the Municipal Participation Fund (FPM). Since constitutional rules increased the share of the tax pie allocated to subnational entities, there is no legal or economic justification for projecting a contraction in the transferred share without an equivalent reduction in the collection of the shared underlying taxes.

Lastly, although the PLOA 2027 methodology accounts for accrual and cash-basis adjustments to reconcile budget estimates with actual disbursements, and the cash-basis adjustment reduced the projected actual transfer of the FPE/FPM/IPI-EE by BRL 3.6 billion relative to the budget appropriations authorized for 2027, this amount does not offset the apparent contradiction in the estimated transfers, as a share of GDP, for the coming years.

The estimates for transfers in the coming years have a direct effect on the projections for the central government's net primary revenue — the amount of revenue that remains in federal coffers after the division of shared tax collection with the other entities of the federation. In other words, this represents a risk of financial shortfall during the execution of the 2027 budget.

¹¹ Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/865129/RAF112_MAI2026.pdf.

¹² Available at: https://www.planalto.gov.br/ccivil_03/constituicao/emendas/emc/emc112.htm.

Expenditure Projections

Table 4 presents the projections for primary expenditures under the PLDO 2027, the PLOA 2027, and RAF No. 113, at current prices and as a share of GDP. Based on the figures in the table, there is a deviation (the largest one) of BRL 23.2 billion (0.2 p.p. of GDP) between the Executive Branch's total primary expenditure and the IFI's most recent projection for next year.

TABLE 4. PROJECTIONS FOR CENTRAL GOVERNMENT PRIMARY EXPENDITURE (PLDO 2027, PLOA 2027, AND RAF NO. 113) – 2027 (BRL BILLIONS AND % OF GDP)

Variables	2027							
	PLDO 2027		PLOA 2027		IFI (RAF No. 113/Jun26)		Diff. PLOA 2027 - IFI (RAF No. 113)	
	BRL billions	% of GDP	BRL billions	% of GDP	BRL billions	% of GDP	BRL billions	p.p. of GDP
Total primary expenditure	2,760.2	18.9	2,830.1	19.1	2,806.9	19.3	23.2	-0.2
Social security benefits	1,204.6	8.2	1,215.1	8.2	1,239.2	8.5	-24.1	-0.3
Personnel and social charges	459.3	3.1	474.1	3.2	457.1	3.1	17.0	0.1
Continuous Cash Benefits (BPC/LOAS)	137.9	0.9	154.2	1.0	161.9	1.1	-7.6	-0.1
Salary Allowance and unemployment benefits	104.8	0.7	104.8	0.7	113.1	0.8	-8.3	-0.1
Supplementation to FUNDEB	73.5	0.5	73.9	0.5	66.7	0.5	7.1	0.0
Court Rulings and Court-Ordered Debt Payments - Current and Capital	30.1	0.2	31.5	0.2	48.8	0.3	-17.3	-0.1
Subsidies, grants, and Proagro	30.7	0.2	35.7	0.2	29.1	0.2	6.6	0.0
Current and Capital Expenditures of the Legislative and Judicial Branches, MPU, and DPU	41.4	0.3	25.7	0.2	23.0	0.2	2.7	0.0
Compensation Fund for States for the Replacement of the IPI by the Selective Tax			33.8	0.2			33.8	0.2
Other mandatory expenses	18.6	0.1	18.3	0.1	7.6	0.1	10.6	0.1
Executive Branch Expenditures Subject to Financial Programming	659.3	4.5	663.1	4.5	646.7	4.4	16.4	0.1
Mandatory with Flow Control	384.6	2.6	396.3	2.7	406.3	2.8	-10.0	-0.1
Discretionary expenses	274.7	1.9	266.8	1.8	240.4	1.7	26.5	0.1
Reserve for parliamentary amendments			44.8	0.3			44.8	0.3

Source: PLDO 2027, PLOA 2027 and RAF No. 113, dated June 2026.

The main deviation between the Executive Branch's and the IFI's estimates lies in the payment of social security benefits. For this item, the IFI estimates execution of BRL 1,239.2 billion (8.5% of GDP) in 2027, while the PLOA projects BRL 1,215.1 billion (8.2% of GDP), a difference of BRL 24.1 billion (0.3 p.p. of GDP) less.

Other significant deviations between the PLOA 2027 and RAF No. 113 expenditures are: (i) personnel and social charges (BRL 17.0 billion, the largest, or 0.1 p.p. of GDP); (ii) the Continuous Cash Benefit (BPC) (BRL 7.6 billion, the smallest, or 0.1 p.p. of GDP); (iii) salary allowance and unemployment benefit (BRL 8.3 billion, the smallest, or 0.1 p.p. of GDP); (iv) Supplementation to Fundeb (BRL 7.1 billion, the largest); (v) court rulings and court-ordered debt payments – current and capital (BRL 17.3 billion, the smallest, or 0.1 p.p. of GDP); (vi) the Compensation Fund for States for the replacement of the IPI by the Selective Tax (BRL 33.8 billion, the largest, or 0.2 p.p. of GDP); (vii) mandatory expenditures with flow control (BRL 10.0 billion, the smallest, or 0.1 p.p. of GDP); and (viii) discretionary expenditures (BRL 26.5 billion, the largest, or 0.1 p.p. of GDP).

The discrepancy between the estimates for RGPS social security benefit payments in 2027, between the Executive Branch (PLOA 2027) and the IFI (RAF No. 113), stems from differences in macroeconomic assumptions, estimates for the growth of the beneficiary stock, and the IFI's skepticism regarding the effectiveness of the spending review measures planned for the coming years.

First, as discussed in the second section of this text, the Executive Branch has a slightly lower inflation projection (as measured by the INPC, from IBGE) for 2027 compared with the IFI. Since the INPC is the legal indexer for adjusting contribution brackets and benefits above the minimum wage, the lower inflation estimate reduces the nominal adjustment to benefits in the model used by the government.

Second, as highlighted by the IFI in RAF No. 112, the main driver of social security expenditure growth since 2021 has been the continuous expansion of the stock of benefits, driven by structural demographic factors (population aging and increased life expectancy at age 65) and by the acceleration of temporary disability benefits (sickness benefits). On the other hand, the Executive Branch's estimates appear to embed more conservative assumptions regarding the number of new benefits granted, both in 2027 and in subsequent years, based on the projections presented in the PLDO.

Third, the budget prepared by the Executive Branch incorporates significant potential savings from management and efficiency measures, particularly the expansion of Atestmed – a system that grants sickness benefits based on documentation alone, without an in-person medical exam – with estimated savings of around BRL 3.1 billion in 2027. The IFI, for its part, takes a more conservative view of this potential savings, since, in fiscal years 2024 and 2025, the actual performance of Atestmed and of fraud-prevention controls fell short of the Executive Branch's projections and was not sufficient to curb the acceleration in the flow of benefit grants.

In the Fiscal Risks Annex of the PLDO 2027, the Executive Branch consolidated and updated a spending review package, projecting cumulative potential savings of BRL 55.4 billion between 2026 and 2029. The estimated annual breakdown of these savings is as follows:

(i) BRL 11.0 billion in 2026; (ii) BRL 16.0 billion in 2027; (iii) BRL 11.3 billion in 2028; and (iv) BRL 17.1 billion in 2029.

The BPC accounts for the largest projected savings, totaling BRL 25.8 billion between 2026 and 2029, to be achieved through administrative measures such as mandatory annual reviews, improved income filters, biometric requirements, biopsychosocial reassessment, and enhanced program governance.

For RGPS social security benefits, the measures project savings of BRL 12.9 billion from 2026 to 2029, to be achieved as follows: (i) BRL 3.0 billion in 2026; (ii) BRL 3.1 billion in 2027; (iii) BRL 3.3 billion in 2028; and (iv) BRL 3.5 billion in 2029. According to the PLDO 2027 documents, the main measures to be adopted to reach these amounts are the previously mentioned expansion of Atestmed and improved registry integrity to strengthen fraud prevention.

In RAF No. 112, which analyzed the PLDO 2027, the IFI discussed these measures and explained its skepticism regarding the effectiveness of the instruments presented, particularly with respect to the projected savings amounts. Making these measures effective may require structural changes to the legislation governing the granting of the BPC and social security benefits.

The fourth and final point to consider regarding social security benefit expenditures concerns the payment of maternity and paternity pay. Both the PLOA 2027 and RAF No. 113 consolidate the cost of these two benefits within the aggregate of RGPS social security benefit expenditures.

In particular, the estimates for maternity pay incorporate the expansion resulting from the Federal Supreme Court (STF) ruling of March 21, 2024, which declared unconstitutional the requirement of a 10-month contribution qualifying period for self-employed workers, individual contributors, optional contributors, and rural workers to be eligible for the benefit. The elimination of the qualifying-period requirement expanded the pool of eligible insured workers.

Paternity pay, in turn, is governed by Law No. 15,371¹³, of March 31, 2026, which expressly establishes that the benefit takes effect on January 1, 2027. Accordingly, its financial effects and corresponding budget execution will become part of the RGPS budget starting next year.

For Continuous Cash Benefit (BPC) expenditure in 2027, the discrepancy between the Executive Branch's and the IFI's estimates lies in the INPC assumption and in the higher underlying growth of the beneficiary stock. For this expenditure, as with social security benefit payments, the IFI prefers to take a more conservative stance regarding the BRL 8.8 billion in savings expected by the government from registry reviews, an amount presented in the Fiscal Risks Annex of the PLDO 2027 and analyzed in RAF No. 112.

¹³ Available at: https://www.planalto.gov.br/ccivil_03/_ato2023-2026/2026/lei/l15371.htm.

For personnel and social charges, still according to Table 4, the IFI projects an amount BRL 17.0 billion higher than the Executive Branch's in the PLOA 2027. The factors explaining next year's personnel expenditure, as well as the discrepancy between the IFI's and the PLOA's estimates, are detailed below.

First, the real annual growth of personnel and social charges expenditure will be strictly limited to the lower bound set under the fiscal framework — that is, a real increase of 0.6% over the LOA 2026 base (adjusted by the accumulated IPCA from July 2025 to June 2026), excluding court rulings¹⁴. The maximum limit calculated for the Executive Branch (excluding the Federal District Constitutional Fund) under this trigger was BRL 369.5 billion. In the PLOA 2027, the government set the appropriation at BRL 361.5 billion, maintaining a safety margin of BRL 8.0 billion below the ceiling allowed under the trigger. With this restraint in place, the annual nominal change in the Executive Branch's personnel expenditure falls to 3.2% in 2027, compared with an average of 7.9% over the 2023–2026 period.

Despite this cap on real growth of up to 0.6% for personnel expenditure starting in 2027, the PLOA absorbs the annualized financial effect of laws approved between 2024 and 2026 that restructured career paths and granted the second installment of pay raises to federal civil servants. This committed impact totals BRL 37.8 billion in the 2027 payroll, stabilizing at around BRL 37.9 billion per year between 2028 and 2030, according to the PLDO.

It is worth noting that personnel expenditure is expected to gradually decline as a share of GDP in the coming years. The Executive Branch's estimates point to a decline from 3.1% of GDP in 2027 to 2.8% of GDP in 2030, while the IFI's projections point to a decline from 3.1% of GDP in 2027 to 3.0% of GDP in 2030.

An important discrepancy between the expenditure estimates in the PLOA 2027 and RAF No. 113 concerns the Federal Government's contribution to the Compensation Fund for States for the Replacement of the IPI by the Selective Tax starting in 2027, the year in which the practical implementation phase of the tax reform begins, with the abolition of PIS and Cofins (replaced by the CBS) and the reduction of the IPI — which will thereafter be levied only residually and concentrated in the Manaus Free Trade Zone, being partially replaced by the Selective Tax (IS) and the CBS. In the PLOA 2027, the Executive Branch included BRL 33.8 billion (0.2% of GDP) as a contribution to that fund, an expenditure not accounted for by the IFI in RAF No. 113.

The compensation to states is provided for under Articles 477, 478, and 479 of the aforementioned LC No. 214. Since IPI collection forms part of the constitutional calculation basis for transfers to states and municipalities, through the FPE and the FPM (Article 159, I

¹⁴ Under Article 6-A of LC No. 200, introduced by LC No. 214. The trigger governed by this provision was activated due to the primary deficit recorded by the central government in fiscal year 2025, assessed in 2026 and applicable to 2027. It applies as a personnel expenditure restraint for all federal branches and autonomous bodies (Executive, Legislative, Judicial, MPU, and DPU).

and II of the Federal Constitution), the immediate drop in the IPI in 2027 would directly affect subnational coffers starting next year.

To prevent this immediate loss, LC No. 214 established that the Federal Government must calculate and disburse this compensation to subnational entities on a monthly basis starting in January 2027. This obligation was incorporated into the PLOA 2027, totaling BRL 33.8 billion. It is worth noting that the disbursement for the Compensation Fund for States for the Replacement of the IPI by the Selective Tax was not provided for in the Medium-Term Budget Framework (MOMP) included in the PLOA 2026. For this reason, the IFI did not include the contribution to the fund in its projections in RAF No. 113.

In the PLOA 2026, the MOMP's multi-year projections followed the logic of sectoral spending limits and monetary benchmarks defined by agency. The PLOA 2027 adopted a new methodology, the Expenditure Baseline, which calculates the actual cost of maintaining existing commitments and public policies in subsequent years.

The inclusion of the monthly calculation of this compensation (supported by Article 477 of LC No. 214 to offset the FPE and FPM losses resulting from the IPI decline) was identified by the Ministry of Planning and Budget as the main driver of the increase in the share of mandatory expenditures in the PLOA 2027 (+0.2 p.p. of GDP).

An important additional clarification: this contribution (BRL 33.8 billion) to the IPI compensation fund is not included in the primary expenditure limit under LC No. 200¹⁵. On the other hand, this primary expenditure is fully accounted for when calculating the primary balance target, under the terms of LC No. 101¹⁶ (the Fiscal Responsibility Law) and the LDO¹⁷.

To conclude this section, a few points regarding the constitutional health and education floors are worth considering. In the PLOA 2027, the Executive Branch allocated appropriations that meet or exceed the constitutional and legal requirements. For the health floor (Public Health Actions and Services – 15% of the Federal Government's Net Current Revenue), the calculated amount was BRL 272.2 billion, the same amount allocated to the corresponding appropriation.

¹⁵ As are the contributions to the Fiscal Benefits Compensation Fund (FCBF) and the Regional Development Fund (FNDR), scheduled to begin in fiscal year 2029. These contributions are expressly excluded from the calculation basis for the limits set under LC 200/2023, pursuant to Articles 12 and 15 of Constitutional Amendment (EC) No. 132, of 2023. Text of EC 132 available at: https://www.planalto.gov.br/ccivil_03/constituicao/emendas/emc/emc132.htm.

¹⁶ Available at: https://www.planalto.gov.br/ccivil_03/leis/lcp/lcp101.htm.

¹⁷ The constitutional text and budget legislation provide for specific deductions from the calculation of the fiscal target only for qualified expenditures, such as the portion of court-ordered debt payments (EC No. 136/2025), strategic Defense projects (LC No. 221/2025), and health and education actions under the Social Fund (LC No. 223/2025). Since the IPI compensation is not included in this list of exceptions, its disbursement puts pressure on the above-the-line primary balance and requires coverage by primary revenue to ensure that the center of the 0.5% of GDP surplus target is met.

For the education floor (Maintenance and Development of Education — 18% of Net Tax Revenue), the amount considered was BRL 138.8 billion. The appropriation allocated to the floor, however, was BRL 141.2 billion, generating a margin of BRL 2.4 billion.

For the investment floor (0.6% of GDP under the Sustainable Fiscal Regime of LC No. 200), the amount considered was BRL 88.7 billion (0.6% of GDP). The appropriation allocated, in turn, was BRL 133.8 billion, comfortably exceeding the floor set under the fiscal framework.

Some rules and adjustment mechanisms were incorporated into the 2027 budget. The amount required to comply with the floors in 2027 was affected by recent legislative changes. The first change was introduced by LC No. 235¹⁸. Article 14 of the law establishes that, due to the projected primary deficit in 2026, growth in expenditures financed by earmarked revenue is conditioned on the growth of the fiscal framework limit (IPCA + 2.5%). The same provision excludes oil sales revenue from the calculation of the Federal Government's Net Current Revenue (RCL).

These measures, therefore, reduce the automatic growth of the calculation base for the constitutional health floor and generate savings of BRL 8.9 billion in 2027, according to the Executive Branch's projections. The effects of LC No. 235 are not incorporated into the IFI's most recent estimates (RAF No. 113).

The second legislative change relevant to the preparation of the 2027 budget was the Pé-de-Meia Program. The funds allocated to the upper secondary education savings program — BRL 10.5 billion in the PLOA 2027 — are now classified as scholarships and counted toward compliance with the minimum spending requirement for Maintenance and Development of Education (MDE).

Lastly, the requirement that at least 50% of committee amendments be earmarked for Public Health Actions and Services (ASPS), under LC No. 210¹⁹, of 2024, helps ensure compliance with the health floor.

Since the health (15% of RCL) and education (18% of RLI) floors track federal revenue collection, upward revisions to revenue projections automatically raise the minimum required amounts for both functions. In addition, the mandatory compliance with these floors — combined with the underlying growth in social security benefits, the BPC, and the execution of mandatory amendments — further deepens the structural rigidity of the public budget, reducing the room for non-rigid discretionary expenditures by the Executive Branch over the medium term.

Accordingly, measures that help ensure compliance with the floors and decouple expenditures from revenue ease budget execution and relieve pressure on the expenditure limits under the fiscal framework.

¹⁸ Available at: https://www.planalto.gov.br/ccivil_03/leis/lcp/lcp235.htm.

¹⁹ Available at: https://www.planalto.gov.br/ccivil_03/leis/lcp/lcp210.htm.

The LC No. 200 Expenditure Cap and Its Scope

This section presents the calculation of the Executive Branch's primary expenditure cap under the PLOA 2027 and assesses whether the amounts programmed in the proposal for mandatory expenditures subject to the limits of Complementary Law (LC) No. 200, of 2023, are consistent with its recent trajectory.

The calculation of the 2027 cap starts from a base of BRL 2,392.6 billion. This amount is adjusted by the twelve-month accumulated IPCA variation through June 2026, of 4.6%, and by real growth of 2.5%. The combined application of these factors results in a nominal adjustment of 7.3% and a cap of BRL 2,566.2 billion.

The PLOA adds BRL 10.4 billion to the cap due to the difference between the IPCA projected for the end of 2026, of 5.1%, and the accumulated IPCA through June of this year, of 4.6%. With this addition, the cap considered for 2027 reaches BRL 2,576.5 billion. The incorporation of this amount depends on confirmation of the inflation difference projected in the proposal (Table 5).

TABLE 5. EXPENDITURE CAP FOR 2027 UNDER THE PLOA

Breakdown	Amount
A. 2026 calculation base	BRL 2,392.6 billion
B. Nominal adjustment to the base	7.3%
B.1. Accumulated 12-month IPCA through June 2026 4.6%	4.6%
B.2. Real growth	2.5%
C. 2027 cap before the addition for the IPCA difference $[A \times (1 + B/100)]$	BRL 2,566.2 billion
D. Addition for the difference between the IPCA projected for December and the accumulated IPCA through June 2026 BRL 10.4 billion	BRL 10.4 billion
E. 2027 cap with the addition [C + D]	BRL 2,576.5 billion

Source: Presidential Message of the PLOA 2027, Table 14. Prepared by: IFI.

The LC No. 200 cap does not cover all primary expenditures. Among the main excluded expenditures are revenue-sharing transfers, court-ordered debt payments, the Fundeb, the FCDF, the Compensation Fund for the Replacement of the IPI by the Selective Tax, and certain expenditures of the Legislative and Judicial Branches, the MPU, and the DPU.

According to Table 15 of the Presidential Message, total primary expenditures under the PLOA 2027 amount to BRL 3,418.5 billion. Of this amount, BRL 592.4 billion corresponds to revenue-sharing transfers and BRL 249.5 billion to other primary expenditures not subject to the caps. Adding the two categories together, expenditures excluded from the cap total BRL 841.9 billion, or 24.6% of total primary expenditure.

Excluding revenue-sharing transfers, BRL 2,826.1 billion in primary expenditures remain. Of this amount, BRL 2,576.5 billion is subject to the LC No. 200 caps and BRL 249.5 billion is not. Expenditures not subject to the cap therefore correspond to 8.8% of this total (Table 6).

TABLE 6. PRIMARY EXPENDITURES SUBJECT AND NOT SUBJECT TO THE CAPS UNDER THE PLOA 2027 (BRL BILLIONS)

Breakdown	BRL billions
A. Primary expenditures subject to the caps	2,576.5
B. Primary expenditures not subject to the caps, excluding revenue-sharing transfers	249.5
C. Total primary expenditures, excluding revenue-sharing transfers [A + B]	2,826.1
D. Share of expenditures not subject to the caps in this total [B / C]	8.8%

Source: Presidential Message of the PLOA 2027, Table 15. Prepared by: IFI.

According to the 3rd Two-Month Period Assessment of 2026, primary expenditures subject to the caps are estimated at BRL 2,410.6 billion (17.6% of GDP) for this year. In the PLOA 2027, they are programmed at BRL 2,576.5 billion (17.4% of GDP).

Mandatory expenditures subject to the caps are estimated at BRL 2,172.9 billion (15.9% of GDP) for 2026 and programmed at BRL 2,304.3 billion (15.6% of GDP) for 2027. Discretionary expenditures, in turn, are estimated at BRL 237.7 billion (1.7% of GDP) in 2026 and programmed at BRL 272.2 billion (1.8% of GDP) in the PLOA 2027 (Table 7).

TABLE 7. PRIMARY EXPENDITURES SUBJECT TO THE LC NO. 200 CAPS (BRL BILLIONS AND % OF GDP)

Breakdown	3rd RARDP 2026	PLOA 2027	% GDP 2026	% GDP 2027	Δ p.p. GDP
Expenditure subject to the cap	2,410.6	2,576.5	17.6%	17.4%	-0.2
Mandatory, Subject to Cap	2,172.9	2,304.3	15.9%	15.6%	-0.3
Social Security benefits	1,081.8	1,169.3	7.9%	7.9%	0.0
Personnel and Social Charges	416.9	440.7	3.1%	3.0%	-0.1
Bolsa Família	155.8	157.1	1.1%	1.1%	-0.1
Continuous Cash Benefit (BPC)	136.0	145.1	1.0%	1.0%	0.0
Salary Allowance and Unemployment Benefit	98.2	104.7	0.7%	0.7%	0.0
Other Mandatory Expenditures	284.2	287.4	2.1%	1.9%	-0.1
Discretionary, Subject to Cap	237.7	272.2	1.7%	1.8%	0.1
Expenditure Cap	2,392.7	2,576.5	17.5%	17.4%	-0.1

Source: 3rd RARDP of 2026; Presidential Message and Presentation of the PLOA 2027. Prepared by: IFI. Note: the figures by category in this table reflect only the portion subject to the cap; they may therefore differ from the total

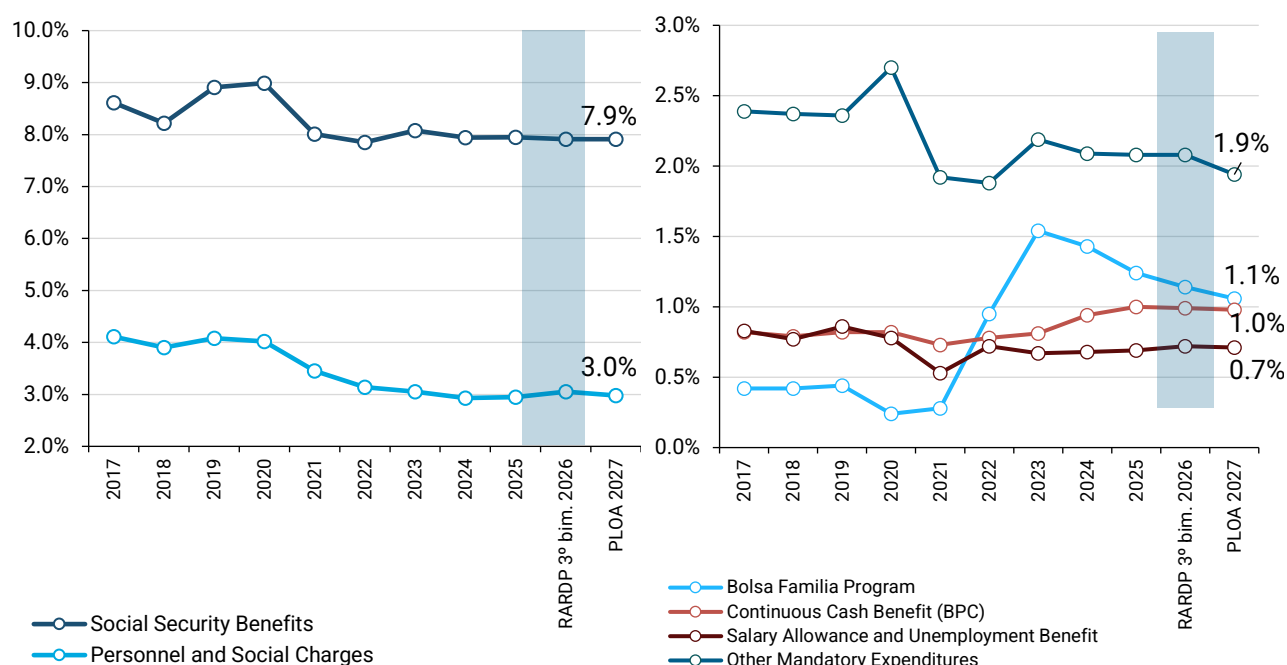
primary expenditure figures presented in Table 4, which also include the portion not subject to the cap (for example, court rulings and court-ordered debt payments related to social security and personnel expenditures).

During the 3rd RARDP assessment of 2026, expenditures subject to the cap exceeded it by BRL 17.9 billion, which led to a freeze on discretionary spending. Net of this freeze, the discretionary space compatible with the cap was estimated at BRL 219.8 billion. For 2027, the PLOA allocates BRL 272.2 billion for discretionary expenditures subject to the caps, which is BRL 52.4 billion more than this space.

According to the 2026 estimate, mandatory expenditures absorb 90.8% of the cap, leaving 9.2% for discretionary expenditures. In the PLOA 2027, these figures are 89.4% and 10.6%, respectively, indicating that a smaller portion of the cap is absorbed by mandatory expenditures, leaving more residual space for discretionary expenditures.

Comparing the figures as a percentage of GDP makes it possible to assess the trajectory of expenditures relative to the size of the economy. Graph 1 shows the annual trend in mandatory expenditures subject to the caps from 2017 to 2027.

GRAPH 1. MANDATORY EXPENDITURES SUBJECT TO THE LC NO. 200 CAPS (% OF GDP)



Sources: Siga Brasil; Primary Revenue and Expenditure Assessment Report for the 3rd RARDP of 2026; Presidential Message and Presentation of the PLOA 2027. Prepared by: IFI. Methodological note: the figures for 2017 to 2025 correspond to actual execution, while the figures for 2026 and 2027 refer, respectively, to the 3rd RARDP assessment and to the PLOA. For years prior to the entry into force of LC No. 200, expenditures were classified according to the scope adopted in this analysis, in order to allow comparison over the period. The 2026 and 2027 shares use the nominal GDP figures considered in the respective official documents.

Reading the individual categories reveals distinct trajectories. Social security benefits remain the main component of mandatory expenditures subject to the caps and maintain a share close to recent levels. Personnel and social charges, as well as salary allowance and unemployment benefit, also remain relatively stable as a share of GDP, while Bolsa Família

and other mandatory expenditures show a gradual decline. The BPC increased its share of GDP in recent years, but the PLOA projects it will stabilize at around 1.0% of GDP.

The PLOA projects a moderate decline in the share of mandatory expenditures subject to the caps as a proportion of GDP, but not a nominal reduction in spending. Between 2026 and 2027, these expenditures increase by BRL 131.4 billion, or 6.0%. The change from 15.9% to 15.6% of GDP depends largely on the nominal growth projected by the Executive Branch. In addition, most of the increase in mandatory expenditures is concentrated in social security benefits, personnel and social charges, and the BPC. If mandatory expenditures are revised upward or the containment measures fail to produce the expected effects, the increase will need to be offset by freezes on discretionary expenditures.

Primary Balance Projections

This section analyzes the figures presented in the PLOA regarding the central government's primary balance in 2027. Table 8 presents the projections from the PLDO 2027, the PLOA 2027, and RAF No. 113.

According to the table, there is a difference (the largest) of BRL 104.8 billion (0.7 p.p. of GDP) between the actual primary balance estimates in the PLOA 2027 (a surplus of BRL 18.6 billion, or 0.1% of GDP) and in RAF No. 113 (a deficit of BRL 86.1 billion, or 0.6% of GDP) for 2027. Still according to the table, the central government's net primary revenue projected in the PLOA is BRL 127.9 billion higher than the IFI's estimate, while primary expenditure is BRL 23.2 billion higher.

TABLE 8. PROJECTIONS FOR THE CENTRAL GOVERNMENT'S PRIMARY BALANCE (PLDO 2027, PLOA 2027, AND RAF NO. 113) – 2027

Variables	2027							
	PLDO 2027		PLOA 2027		IFI (RAF No.113/Jun26)		Diff. PLOA 2027 - IFI (RAF No. 113)	
	BRL billions	% of GDP	BRL billions	% of GDP	BRL billions	% of GDP	BRL billions	p.p. of GDP
1. Net primary revenue	2,768.2	18.90	2,848.7	19.30	2,720.8	18.72	127.9	0.6
2. Total primary expenditure	2,760.2	18.85	2,830.1	19.10	2,806.9	19.31	23.2	-0.2
3. Actual primary balance [1-2]	8.0	0.05	18.6	0.10	-86.1	-0.59	104.8	0.7
4. Central government – deductions from the primary balance target ⁽¹⁾	65.7	0.45	64.7	0.40	87.0	0.60	-22.3	-0.2
5. Central government – primary balance after deductions (1) [3+4]	73.6	0.50	83.4	0.60	0.9	0.01	82.5	0.6
6. Central government – center of the primary balance target	73.2	0.50	73.2	0.50	73.2	0.50	0.0	0.0
7. Central government – lower bound of the primary balance target	36.6	0.25	36.6	0.25	36.6	0.25	0.0	0.0
8. Difference from the lower bound of the primary balance target [5-7]	37.0	0.25	46.7	0.35	-35.7	-0.24	82.5	0.6

⁽¹⁾ Court rulings, pursuant to Article 165, paragraphs 21 and 22, of the 1988 Federal Constitution, LC No. 221/2025, LC No. 223/2025, and Law No. 15,164/2025.

Source: PLDO 2027, PLOA 2027 and RAF No. 113, June, 2026.

It is worth explaining the legal deductions of expenditures from the calculation of the primary balance target considered for 2027. The Executive Branch included BRL 64.7 billion, comprising: (i) BRL 59.2 billion related to the portion of court-ordered debt payments (precatórios) and RPVs exceeding the amount gradually incorporated into the target calculation (Article 165, paragraphs 21 and 22, of the 1988 Federal Constitution), corresponding to 39.4% of total court-ordered debt payment and RPV expenditure; (ii) BRL 5.0 billion in spending on strategic national defense projects, under LC No. 221; and (iii) BRL 0.6 billion²⁰ in funds for education and health financed by the Social Fund, under LC No. 223 and Law No. 15,164²¹, of 2025

In RAF No. 113, the IFI projected BRL 87.0 billion in legal deductions of expenditures from the calculation of the 2027 primary target. The difference (the largest) of BRL 20.1 billion (BRL 79.3 billion from the IFI, minus BRL 59.2 billion from the PLOA) in deductions related to court-ordered debt payments and RPVs is due to the IFI having projected a larger deduction to be considered by the Executive Branch in the budget.

For health and education spending financed by the Social Fund, the IFI projected a deduction of BRL 2.8 billion in RAF No. 113 for fiscal year 2027. The aforementioned LC No. 235 was enacted in August, after RAF No. 113 was published. Lastly, for defense spending, the IFI considered the same deduction amount as the PLOA 2027 (BRL 5.0 billion) in its projection for 2027.

From the standpoint of the PLOA 2027 estimates, starting from an actual primary surplus of BRL 18.6 billion, adding the legal deductions of BRL 64.7 billion raises the recorded balance to BRL 83.4 billion. This amount exceeds the center of the target set for next year (a surplus of BRL 73.2 billion), with a margin of BRL 10.1 billion.

RAF No. 113, in turn, starts from a projected actual primary deficit of BRL 86.1 billion in 2027. Adding BRL 87.0 billion in deductions results in a recorded primary surplus of BRL 0.9 billion. Thus, according to the IFI's estimates, there would be formal noncompliance with the 2027 target, with the primary balance BRL 72.3 billion below the center of the target (BRL 73.2 billion) and BRL 35.7 billion below the floor of the tolerance band (BRL 36.6 billion). As discussed in RAF No. 113, in light of these figures, it would be possible to meet next year's primary target through spending cuts of BRL 35.7 billion in discretionary expenditures.

Concluding Remarks

The assessment of the PLOA 2027 confirms the pattern already identified by the IFI in previous analyses: formal compliance with the fiscal target remains possible next year, but depends on more optimistic assumptions than those adopted by this institution and on a much narrower safety margin than the one presented by the Executive Branch. While the

²⁰ LC No. 235 brought forward BRL 3.0 billion of this allowance to fiscal year 2026, proportionally reducing the usable ceiling for 2027 to BRL 555.2 million.

²¹ Available at: https://www.planalto.gov.br/ccivil_03/_ato2023-2026/2025/lei/l15164.htm.

PLOA projects a recorded primary surplus of BRL 83.4 billion — BRL 10.1 billion above the center of the target — the IFI's scenario points to a recorded surplus of BRL 0.9 billion, insufficient even to reach the lower bound of the tolerance band. Under these estimates, additional spending cuts of BRL 35.7 billion in non-rigid discretionary expenditures would be needed to ensure formal compliance with the target in 2027.

The origin of this BRL 104.8 billion divergence (a surplus of BRL 18.6 billion projected in the PLOA 2027 versus a deficit of BRL 86.1 billion estimated by the IFI) in the actual primary balance is distributed significantly across both revenue and expenditure. On the revenue side, the PLOA is based on more favorable macroeconomic assumptions — real growth of 2.5% versus 1.8% for the IFI, with an additional downside bias signaled by the most recent activity data — and on parameters that are still provisional for CBS and Selective Tax collection, taxes that still lack definitive regulation by the National Congress. On the expenditure side, the main source of divergence is the IFI's skepticism regarding the effectiveness of the spending review measures projected by the Executive Branch for social security benefits and the BPC, whose performance in 2024 and 2025 fell short of estimates.

It is also worth highlighting a structural point that extends beyond fiscal year 2027: the introduction of the contribution to the Compensation Fund for States for the Replacement of the IPI by the Selective Tax (BRL 33.8 billion) illustrates how the design of the tax reform transition can generate significant new primary expenditures that are not subject to the LC No. 200 cap but are fully counted in the calculation of the primary balance target.

The analysis of the primary expenditure cap reinforces the diagnosis of growing budgetary rigidity. Although the PLOA projects a decline in the share of mandatory expenditures subject to the caps, from 90.8% to 89.4% of the available space between 2026 and 2027, this improvement depends entirely on the nominal growth projected by the Executive Branch — in absolute terms, mandatory expenditures increase by BRL 131.4 billion over the period. If mandatory expenditures are revised upward over the course of next year, or if the containment measures fail to produce the expected effect, the necessary adjustment will once again fall on freezes to discretionary expenditures — repeating the pattern observed throughout 2026 and documented in this year's RARDPs.

Lastly, it is worth reaffirming that the divergences between the Executive Branch's and the IFI's estimates for 2027 do not stem from a technical error on either side, but from methodological choices and legitimate assumptions, albeit with differing degrees of conservatism. The magnitude of these divergences — equivalent to more than one and a half times the center of the fiscal target itself — nonetheless underscores the importance of continuously monitoring budget execution throughout 2027, particularly in the first year of the next presidential term, when the credibility of the assumptions adopted today will be put to the test.

Risk Premium and Fiscal Policy in Brazil

Rafael Curi and Alexandre Andrade

Introduction

The persistence of high interest rates in Brazil is one of the most recurring themes in the national economic debate. As a technically complex debate, it requires prior knowledge of macroeconomic theory concepts, and carries an additional element that hinders public understanding: competing rather than complementary explanations vie for the diagnosis, reflecting both the plurality of the subject and the uncertainty surrounding Brazil's macroeconomic and fiscal environment.

The current moment illustrates this debate well – and a paradox that lies at its core. On one hand, fiscal policy is conducted under formal primary balance targets; on the other, General Government Gross Debt (DBGG) reached 82.5% of GDP in July 2026, according to the Central Bank. This trend is driven not only by the actual primary deficits of recent years, but also by the cost of financing existing debt.

Over the twelve months through July, nominal interest payments and net debt issuances alone accounted for 10.5 p.p. of GDP in the increase in the DBGG – more than offsetting the 5.2 p.p. reduction the indicator received from GDP growth over the same period, according to data on the drivers of gross debt published by the Central Bank²². In other words, even when fiscal policy formally meets the established targets, servicing the debt itself can outpace the consolidation effort – a self-referential mechanism that helps frame the object of this analysis.

This mismatch has a monetary counterpart. The long-term real interest rate, which stood at around 5% p.a. in 2018, reached 8.3% p.a. in September 2026, showing that the government has been paying increasingly higher interest rates to finance itself. The nominal Selic rate, in turn, remains close to 14% p.a.

Without claiming to be exhaustive, it is possible to identify some of the main lines of thought competing for this diagnosis. Part of the literature focuses on the formation of the Selic rate, attributing its high level to public spending growth above the economy's potential, which would generate systematic demand shocks under the inflation-targeting regime²³.

A complementary reading links the high interest rate to low domestic savings, insufficient to finance all investment²⁴ – a finding that connects to the broader debate on institutional

²² Figures available at: <https://www.bcb.gov.br/estatisticas/estatisticasfiscais>.

²³ See, for example, Pessôa, S. (2026). "Os juros elevados brasileiros." IBRE Blog, dated 08/26/2026, available at <https://blogdoibre.fgv.br/posts/os-juros-elevados-brasileiros>.

²⁴ Hausmann (2008) goes so far as to call it the most relevant constraint on Brazilian growth, and Segura-Ubiergo (2012), in a panel of 15 emerging inflation-targeting countries, estimates that an increase in public savings has an effect on the

weaknesses, such as the "jurisdictional uncertainty" coined by Arida, Bacha, and Lara-Resende (2005): the risk that long-term contracts may have their value altered by decisions of the Judiciary, the Legislature, or the Executive Branch, which would help explain why Brazil never developed a long-term private credit market – and, without this market, domestic savings have fewer channels through which to be converted into long-term financing²⁵.

A third line of thought points to the design of monetary policy itself: Brazil's inflation target today is tighter than that of most peer emerging economies²⁶, and mechanisms such as directed credit and price indexation²⁷ weaken the transmission of the Selic rate to the real economy. Along similar lines, a more recent argument highlights the role of exchange rate volatility, whose asymmetric pass-through to inflation would feed back into the high-interest-rate cycle itself²⁸.

This analysis seeks to contribute to this debate without arbitrating between these readings – instead empirically testing the weight of some of the factors described, such as the fiscal outlook, the external scenario, and exchange rate volatility. To do so, the long-term nominal interest rate is decomposed into two components: the accumulated expectation of the Selic rate's own trajectory and the risk premium (or term premium) demanded by the market to hold Brazilian public debt. As will be argued throughout the text, it is the premium – not the expectation – that accounts for most of the recent volatility in the long rate and that proves more sensitive to the fiscal outlook, which shifts the diagnosis: the country's high cost of long-term financing does not stem solely from the current conduct of monetary policy, but from a structural distrust that this policy, on its own, has no instrument to resolve.

Beyond this introduction, the paper is organized as follows. Section 2 presents a brief history of real interest rates in Brazil, comparing them with those of a group of peer countries and showing how the observed gap in the policy rate propagates to the cost of bank credit. Section 3 discusses the formation of interest rates in Brazil based on the decomposition of the five-year nominal rate into accumulated expectations and the risk premium. Section 4 further examines the fiscal component identified in this decomposition, analyzing its evolution over time and its concentration at the longer tenors of the term structure. Section 5 discusses a second channel of interaction between fiscal policy and interest rates, associated with the composition of public debt by indexer. The final section presents the concluding remarks.

real interest rate up to three times larger than an equivalent increase in private savings – even so, the model leaves around 2 percentage points of the Brazilian interest rate unexplained, a country-specific residual.

²⁵ This thesis was empirically tested in Gonçalves, Holland, and Spacov (2007), who found little support for it in the data. In a more recent discussion, the argument reappears that legal insecurity, litigiousness, and tax complexity are the true "Brazil cost" behind the high interest rate (see Vescovi (2026), available at <https://www1.folha.uol.com.br/colunas/ana-paula-vescovi/2026/02/o-custo-brasil-para-alem-dos-juros.shtml>).

²⁶ There is an important ongoing debate about the adequacy of Brazil's inflation target. For details, see Carter et al. (2026).

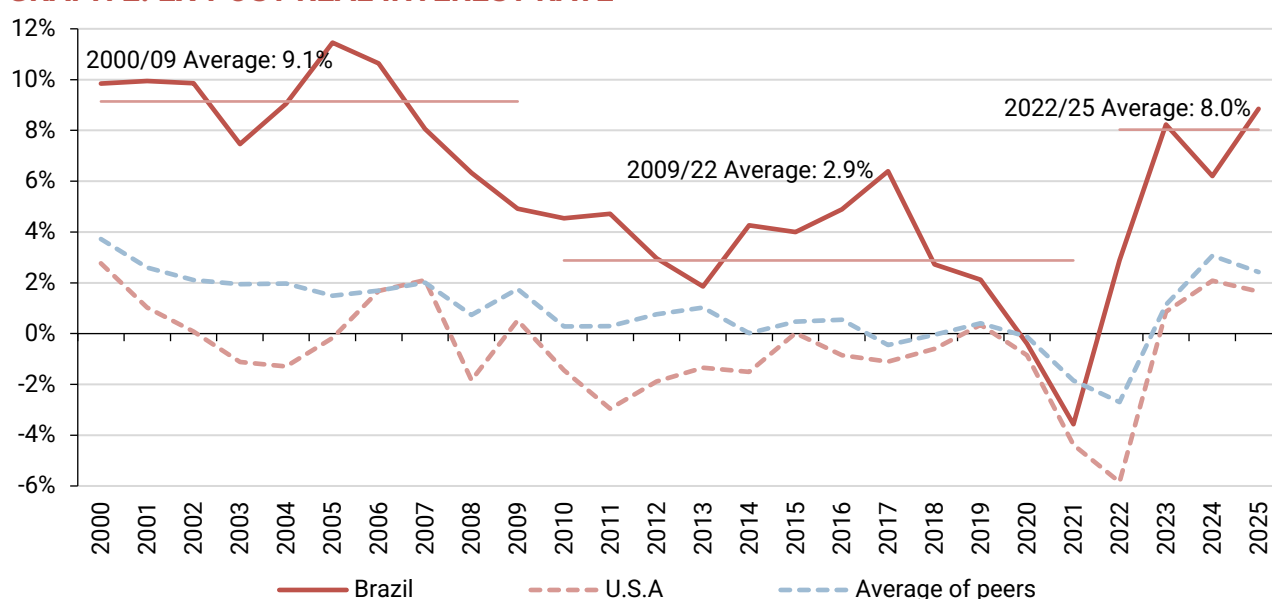
²⁷ See Holland (2026) and Segura-Ubiergo (2012).

²⁸ See Klein (2026), available at <https://www1.folha.uol.com.br/mercado/2026/09/um-terceiro-fator-para-os-juros-altos.shtml>.

A Brief History of Real Interest Rates in Brazil

To motivate the analysis, Graph 2 compares Brazil's real interest rate with that of a group of peer countries. The average real interest rate shifts level at three points in the sample²⁹: from 2000 to 2009, it stood at an average level of 9.1% p.a.; from 2009 to 2022, it fell to 2.9% p.a.; in the most recent period, from 2022 to 2025, the average real interest rate returned to a level close to that observed in the 2000s, averaging 8.0% p.a.

GRAPH 2. EX-POST REAL INTEREST RATE



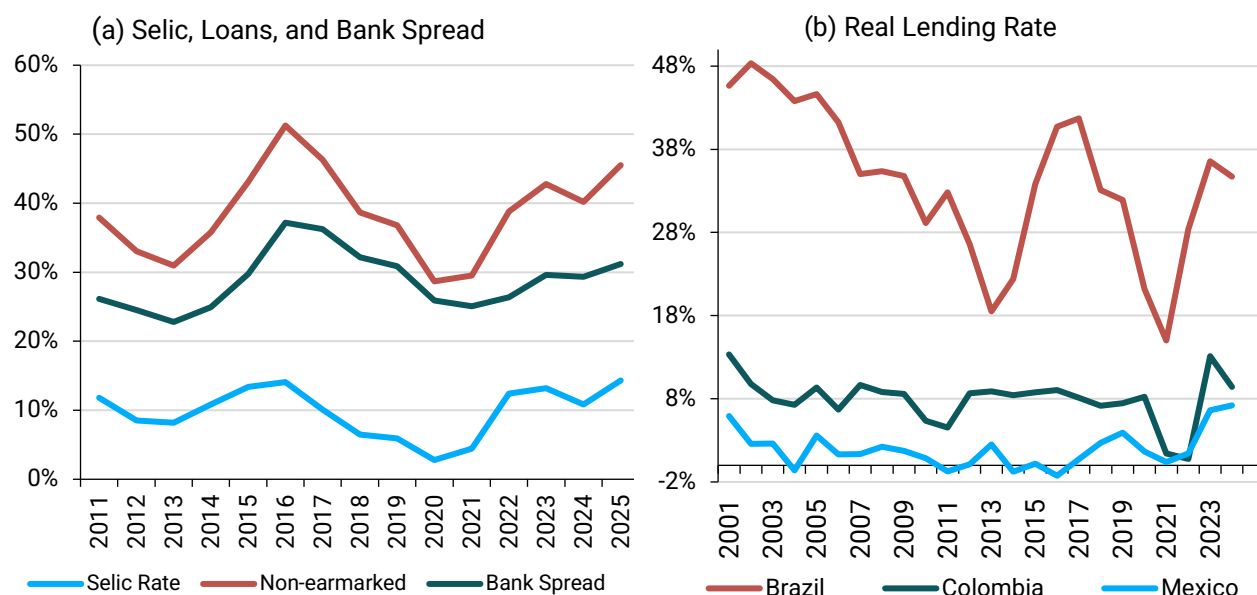
Source: BCB, FRED/OCDE and Macrosights. The real interest rate is calculated using the Fisher equation, given by $1 + r = (1 + i)/(1 + \pi)$, where r is the real interest rate, i is the nominal rate, and π is the inflation observed over the period. Peer countries: Mexico, New Zealand, Canada, Chile, Hungary, Indonesia, and Japan. Prepared by: IFI.

The first notable observation is that Brazil operates with a real interest rate systematically above the average of its peers across all identified regimes. This pattern suggests that the persistence of Brazilian interest rates cannot be understood solely through cyclical movements, motivating an investigation of the domestic and external factors that may contribute to their formation.

The persistence and discrepancy of high interest rates in Brazil are not limited to the policy rate: bank credit amplifies the gap between Brazil and countries with comparable inflation, as illustrated in panels (a) and (b) of Graph 3. Between 2015 and 2024, the average real bank lending rate was 31.7% p.a. in Brazil, compared with 7.4% p.a. in Colombia and 2.4% p.a. in Mexico – a difference that inflation alone does not fully explain. Holland (2026) explored this feature of the Brazilian financial system, attributing the structural disconnect between the policy rate and the cost of credit to factors such as credit risk, default rates, operating costs, tax burden, regulatory requirements, and financial intermediation margins.

²⁹ Identified using the Bai and Perron (1998) structural break test, which endogenously identifies regime changes over the course of the sample.

GRAPH 3. REAL INTEREST RATE AND COST OF CREDIT



Source: (a) Central Bank of Brazil, SGS; (b) World Bank, World Development Indicators. Prepared by: IFI.

The two exercises above document the stylized fact of interest: Brazil's real interest rate remains historically high relative to that observed in other countries, and this differential is also reflected in the cost of credit to households and firms. They do not, however, show why this happens, nor how much of each link in this chain is attributable to the various types of uncertainty discussed above.

To move in this direction and, in particular, to assess the fiscal dimension, this analysis decomposes the five-year nominal rate into two components: the expected trajectory of short-term interest rates and the risk premium required for holding longer-term government securities. The first component is more directly associated with expectations about the future conduct of monetary policy. The second corresponds to the compensation investors require given the risks involved in maintaining these positions. As will be shown below, the premium is the most volatile component of the long rate and shows a significant association with the fiscal position.

This decomposition refers to government bond rates and, therefore, to only one stage in the formation of the final cost of credit. For loans to households and firms, the bank spread is added on top – 20.9 p.p. in July, according to the Central Bank – which incorporates factors such as credit risk and default rates, operating costs, taxation, the macroeconomic environment, and intermediation margins.

The exercise presented below therefore focuses on one specific stage of this chain: the decomposition of the long rate and the identification of the factors associated with the formation of its risk premium component.

Drivers of Interest Rates in Brazil – Expectations and Risk Premium

This section addresses the issue of high interest rates in Brazil using a decomposition of the long-term nominal interest rate into two components: the accumulated expectation of short-term interest rates and the risk premium. For this purpose, it adopts as its methodological reference the strategy used by the Central Bank of Brazil in a box in the June 2025 Monetary Policy Report, which combines the estimation of the nominal interest rate term structure with the decomposition proposed by Adrian, Crump, and Moench (2013), hereafter referred to as ACM³⁰. The yield curve is estimated from government securities (LTNs and NTN-Fs, or, under the new nomenclature, Tesouro Prefixado and Tesouro Prefixado com Juros Semestrais) using the Svensson (1995)³¹ interpolation. This analysis also focuses on the premium component, for several reasons. First, the risk premium, as will be shown below, is the most volatile component of the nominal rate, so most of the fluctuations in the long-term rate stem from changes in the premium, not from the expected path of the Selic rate.

Second, it is in the premium, not in the expectation, that compensation for fiscal risk and debt sustainability tends to be concentrated: the expectation mostly reflects the current conduct of monetary policy in response to inflation and activity, while the premium captures the uncertainty of holding public debt over a longer horizon³². Thus, in this exercise, the expectations component represents the market's reaction function to current information about the direction of monetary policy.

This relationship can be formalized by the following expression³³:

$$(1 + n y_t^{(n)}) = E_t \left[(1 + y_t^{(1)}) (1 + y_{t+1}^{(1)}) \cdots (1 + y_{t+n-1}^{(1)}) \right] (1 + n \cdot TP_t^{(n)}) \quad (1)$$

where $y_t^{(n)}$ is the spot rate of the long-term bond, $E_t [\cdot]$ is the accumulated expectation of one-period (overnight) short rates projected by the market for the next n years, and $TP_t^{(n)}$ is the risk premium for maturity n . As mentioned before, n is taken to represent five years.

By way of illustration, consider an investor who purchases a five-year government bond. In theory, this is equivalent to choosing between two strategies: (i) holding the bond to maturity, or (ii) reinvesting the funds overnight, day after day, over the same five-year period. If the investor were indifferent to risk, the return under both strategies would be the same:

³⁰ Adopted by the Central Bank of Brazil itself and detailed in Araujo, Vicente, and Gaglianone (2025).

³¹ See the box in the June 2025 Monetary Policy Report, available at <https://www.bcb.gov.br/content/ri/relatorioinflacao/202506/rpm202506b7p.pdf>.

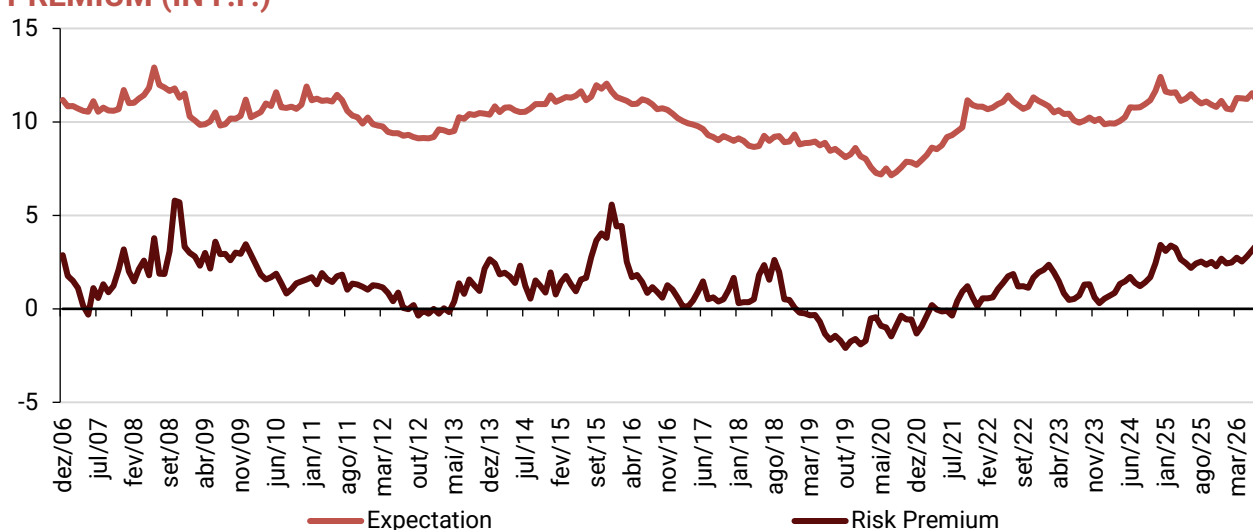
³² The Central Bank characterizes the two components differently: the expectation, according to the terminology used in the Monetary Policy Committee minutes, is more closely tied to monetary policy, reflecting the market's reaction function to information on inflation and activity, while the premium is associated with other types of uncertainty, both external and internal to domestic economic policy, and with the country's fiscal perception. This conceptual distinction is also consistent with the literature on jurisdictional uncertainty (Arida, Bacha, and Lara-Resende, 2005), which argues that it is specifically long-horizon risk, rather than the cost of short-term funding, that lacks a developed domestic market in Brazil, requiring additional compensation.

³³ See the box in the June 2025 Monetary Policy Report, available at <https://www.bcb.gov.br/content/ri/relatorioinflacao/202506/rpm202506b7p.pdf>.

the rate on the long-term bond would represent the accumulated average of the short-term rates expected over the period. Holding the long-term bond, however, entails a risk that is absent from an overnight rollover strategy: if interest rates rise, the bond price falls, and the longer the maturity, the greater its sensitivity to such changes. Investors therefore require additional compensation to prefer the long-term bond, referred to here as the risk premium.

Graph 4 presents the series for the components of the five-year nominal rate, namely the expected short-term forward interest rate and the corresponding risk premium, both estimated using the ACM model.

GRAPH 4. COMPONENTS OF THE FIVE-YEAR NOMINAL RATE: EXPECTATION AND RISK PREMIUM (IN P.P.)



Source: National Treasury and Central Bank of Brazil. Prepared by: IFI, based on the model of Adrian, Crump, and Moench (2013).

The variability of the risk premium, measured by the coefficient of variation, which relates the standard deviation to the mean level of each series, is approximately 9.6 times greater than that of the expectations component.

In the recent period, the risk component is also elevated relative to its historical pattern. In August 2026, the five-year nominal rate reached 14.40% p.a., of which 11.16 p.p. corresponded to interest rate expectations and 3.24 p.p. to the risk premium. The premium thus accounted for 22.5% of the rate in that month, compared with an average share of 9.2% across the sample. The two components also show a correlation of 0.74 in levels, indicating that periods characterized by higher interest rate expectations also tend to coincide with higher premium levels. This co-movement, however, appears to be associated mainly with common macroeconomic regimes, since the correlation between their monthly changes is considerably lower, at 0.39. The formal decomposition is therefore particularly important for distinguishing movements in the expected path of monetary policy from those associated with the compensation required for risk.

Equation (1) above thus corresponds to an identity that follows directly from the ACM model, which makes it possible to calculate, for each month and for the five-year tenor, how much

of the observed nominal rate corresponds to the accumulated expectation of the Selic rate and how much corresponds to the risk premium.

The objective is to assess the extent to which domestic, fiscal, and external conditions help explain its movements, distinguishing the portion related to internal fundamentals from that associated with the international financial environment. To this end, a linear regression model is estimated by Ordinary Least Squares (OLS), in which the five-year risk premium is the dependent variable and the potential determinants are included as regressors³⁴.

$$Prêmio_t = \beta_0 + \beta_1 \cdot Focus_{t-1} + \beta_2 \cdot TLP_{t-1} + \beta_3 \cdot Selic_{t-1} + \beta_4 \cdot TIPS5_{t-1} + \beta_5 \cdot (USPRE10 - USPRE2)_{t-1} + \beta_6 \cdot DBGG_{t-1} + \beta_7 \cdot VolCambial_{t-1} + \varepsilon_t$$

(2)

where $Prêmio_t$ represents the risk premium, following the notation of the model proposed by the Central Bank of Brazil. The explanatory variables are described in Table 9:

TABLE 9. ACM MODEL VARIABLES

Variable	Definition	Unit / lag
Premium	Risk premium of the 5-year nominal rate (ACM model)	% p.a., level, no lag
Focus	Focus Market expectation for IPCA 12 months ahead	% p.a., lagged 1 month
TLP	Long-Term Rate (BNDES funding cost)	% p.a., lagged 1 month
Selic	Selic target in effect (monthly, annualized)	% p.a., lagged 1 month
TIPS_5	Real yield on the 5-year U.S. Treasury	% p.a., lagged 1 month
USPRE10 - USPRE2	Slope of the U.S. yield curve (10y - 2y)	p.p., lagged 1 month
DBGG	General Government Gross Debt (% of GDP), in level	% of GDP, lagged 1 month
Exchange Rate Volatility	Realized exchange rate volatility (21-business-day rolling standard deviation of daily PTAX returns, annualized)	% p.a., lagged 1 month

Prepared by: IFI.

Table 10 presents the results of the regression described in Equation (2) for the period from January 2007 to August 2026.

TABLE 10. REGRESSION RESULTS

Focus	TLP	Selic	TIPS_5	USPRE10 - USPRE2	DBGG	Exchange Rate Volatility
0.45**	0.09**	0.08*	0.73***	0.96***	0.03**	0.02***
(2.40)	(2.14)	(1.81)	(6.03)	(9.12)	(1.97)	(2.99)

Note: N = 235 monthly observations and adjusted R² = 0.70. Values in parentheses correspond to t-statistics. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Source: Prepared by IFI.

³⁴ Since this is a monthly series, subject to both heteroskedasticity and serial correlation of the residuals, statistical inference is performed with HAC robust standard errors, calculated using the Newey and West estimator. This procedure does not change the coefficients estimated by OLS, but it makes the significance tests more robust to the presence of these features in the errors.

Among the domestic factors, inflation expectations (Focus) raise the premium because higher expected inflation is commonly tied to greater uncertainty, which erodes the real return on a fixed-rate bond and signals an inflation-targeting regime that is less anchored over the relevant horizon. The TLP, which is tied to the NTN-B, is a parallel signal of the same long-term cost of capital. The Selic rate, in turn, tends to be elevated in periods of greater macroeconomic stress, which in itself raises the compensation required to hold any long-term asset.

On the fiscal side, the DBGG can raise the risk premium along the term structure by worsening perceptions of debt sustainability. Under the usual dynamics³⁵, higher levels of indebtedness require larger future primary surpluses to stabilize the debt-to-GDP ratio, increasing the risk that the necessary fiscal adjustment will not materialize and, consequently, also the compensation demanded by investors. This mechanism is distinct from the short-term effect of fiscal policy on aggregate demand, which, in the framework adopted here, is captured predominantly by the expected path of the Selic rate. The hypothesis investigated here therefore focuses on the fiscal sustainability channel, which affects the premium associated with holding longer-term securities.

On the external side, the U.S. five-year real rate (TIPS_5) represents a low-risk real return benchmark for the global investor. An increase in this rate raises the opportunity cost of allocating capital to emerging economies and therefore tends to raise the return required for exposure to Brazilian risk. The slope of the U.S. yield curve (USPRE10 - USPRE2), in turn, summarizes changes in expected monetary and financial conditions in the United States and in the relative perception of different maturities, and can be transmitted to the domestic curve through the integration of global fixed-income markets.

Finally, exchange rate movements constitute an additional risk channel: depreciation of the real can raise inflationary uncertainty and, through pass-through³⁶ to prices, reduce the expected real return on fixed-rate bonds, increasing the compensation required by investors. These mechanisms reinforce the interpretation that the Brazilian premium also responds to international financial conditions.

Table 11 reports two complementary magnitude exercises for the regression specification.

³⁵ This refers to the standard public debt dynamics relationship $d_{t+1} = d_t(1 + r)/(1 + g) - s_t$, according to which the evolution of the debt-to-GDP ratio (d_{t+1}) depends on the initial debt stock (d_t), the differential between the real interest rate and the economy's real growth rate ($(1 + r)/(1 + g)$), and the primary balance (s_t). The larger this differential $r - g$, the larger the primary surplus required to stabilize debt. For further discussion, see Blanchard, O. et al. (1990).

³⁶ That is, the transmission of a change in the exchange rate to domestic prices.

TABLE 11. SENSITIVITY AND CONTRIBUTION OF THE VARIABLES TO THE RISK PREMIUM

Variable	ΔPremium (p.p.)	Contribution to the premium's mean level (p.p)
USPRE10 - USPRE2	0.90	0.98
TIPS_5	0.85	0.28
Focus	0.42	2.16
DBGG	0.35	2.16
TLP	0.28	0.72
Selic	0.27	0.81
Exchange Rate Volatility	0.15	0.28

Source: prepared by IFI.

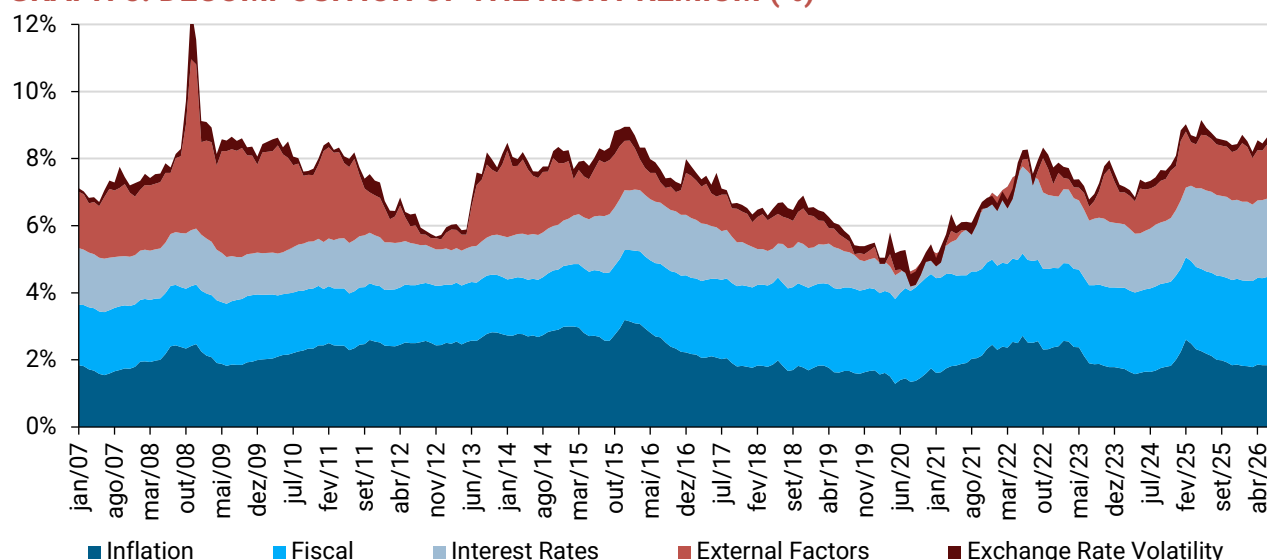
The first column standardizes each coefficient by the standard deviation of the respective variable in the sample, making it possible to compare the premium's response to shocks of typical magnitude across regressors. By this criterion, the external factors show the largest marginal effects: a 1-standard-deviation shock to the slope of the U.S. yield curve (USPRE10 - USPRE2) shifts the premium by 0.9 p.p., while an equivalent shock to the U.S. five-year real rate (TIPS_5) produces a change of 0.85 p.p. Among the domestic factors, however, the DBGG stands out: a 1-standard-deviation shock to gross debt is associated with a 0.35 p.p. change in the premium, a magnitude larger than those estimated for the TLP, the Selic rate, and exchange rate volatility.

The second column offers a complementary reading by multiplying each coefficient by the mean level of the respective variable in the sample, making it possible to measure each factor's contribution to the premium's estimated mean level. Under this criterion, the DBGG emerges among the largest components, with an estimated contribution of 2.16 p.p. This is a relevant result for the fiscal variable: although its marginal coefficient is relatively small, it acts on a high and persistent mean level, equivalent to 66.65% of GDP in the sample. Thus, even a moderate marginal sensitivity translates into a substantial contribution to the level of the premium.

TIPS_5 shows a different pattern. Its coefficient and sample variability mean that typical movements in the U.S. real rate produce significant effects on fluctuations in the premium, but its relatively low mean level limits its contribution to the estimated average level.

Graph 5 extends the decomposition to each period in the sample across five categories: inflation (Focus), fiscal (DBGG), interest rates (Selic + TLP), the external sector (5-year TIPS + slope of the U.S. yield curve), and exchange rate volatility, showing the relative contribution of each factor to the premium's estimated mean level.

GRAPH 5. DECOMPOSITION OF THE RISK PREMIUM (%)



Prepared by: IFI, based on the decomposition of the risk premium (Equation 1) and the regression coefficients.

In the estimated composition of the premium, there are notable differences both in persistence, associated with the sustained level of the premium, as in the cases of inflation and the fiscal position, and in variability, more closely related to fluctuations in the premium over time, as with the external and exchange rate factors.

Starting with the external factors, their importance rises particularly visibly during periods of heightened tension in international markets. The 2008 global financial crisis is the clearest case, when the estimated premium reached a peak of approximately 12%. A second increase occurs between 2013 and 2016, a period marked by the reversal of monetary stimulus in the United States, an episode known as the *taper tantrum*³⁷, compounded by the worsening fiscal situation at home. The external and exchange rate components decline during the pandemic, as U.S. interest rates fell to levels close to zero, and regain importance starting in 2022, in line with the monetary tightening cycle conducted by the Federal Reserve.

In the domestic sphere, the components associated with inflation, interest rates, and the fiscal position show distinct dynamics over the sample. In the inflation component, as expected, more pronounced increases can be observed during episodes of greater inflationary instability, particularly between 2015 and 2016 and after the pandemic, in 2021 and 2022, without, however, any persistent upward trend identifiable across the full sample.

The interest rate component, which combines the Selic rate and the TLP, tracks the cycles of domestic monetary policy more closely and, for this reason, is more sensitive to short- and medium-term changes. Its contribution widens during periods of tighter monetary policy, such as in 2015 and 2016 and, again, in the cycle that began in 2021 and 2022.

³⁷ For further information, see: <https://www.federalreserve.gov/econres/notes/feds-notes/u-s-interest-rates-and-emerging-market-currencies-taking-stock-10-years-after-the-taper-tantrum-20231004.html>.

Conversely, the band narrows during periods of monetary easing, such as in 2012 and 2013 and, especially clearly, in 2020, when the Selic rate reached its historical low.

The fiscal component, represented by the DBGG, has a trajectory that is particularly relevant to the objectives of this study. Initially, its contribution is relatively small compared to the influence of external factors. However, from the mid-2010s onward, its share increases and remains at an elevated level for extended periods. Unlike components more closely tied to international conditions, the fiscal contribution does not markedly decline during periods of reduced external pressure. It remains relevant throughout much of the second half of the sample period.

The next section examines the fiscal component identified in the decomposition to assess the extent to which perceptions of the country's fiscal situation are reflected in the formation of the risk premium embedded in Brazilian interest rates.

The Fiscal Component of the Risk Premium

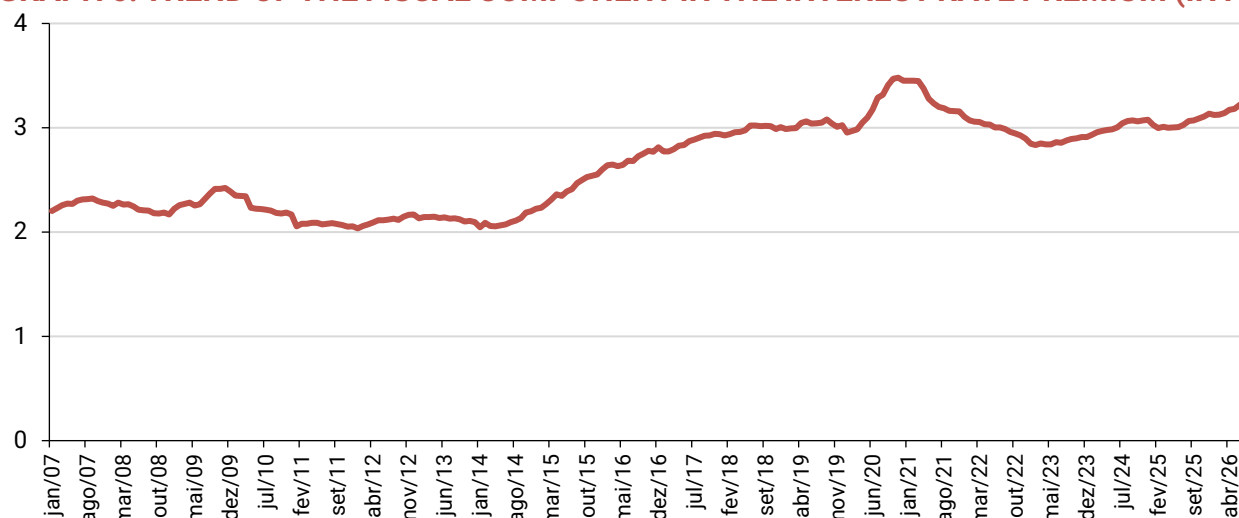
The statistical significance of the DBGG in the regression specified by Equation (2) establishes that the fiscal variable contributes to the formation of the risk premium throughout the sample. Characterizing this relationship, however, requires further analysis of its temporal dimension, of its distribution across the term structure of the risk premium, and of the degree to which it is specific to the Brazilian case.

In particular, the aim is therefore to assess whether the contribution of the fiscal position to the estimated level of the premium remains stable or intensifies over time, at which maturities this relationship is more pronounced, and to what extent it reflects a mechanism particular to Brazil or a pattern common to emerging markets. This section examines these dimensions through two complementary exercises: (i) assessing, based on the decomposition presented in the previous section, the time path of the DBGG; and (ii) assessing whether the effect is concentrated at the short or long end of the risk premium.

Trend of the Fiscal Component in the Interest Rate Premium

To explore the contribution of the fiscal position to the estimated level of the premium, the first exercise isolates, over time, the fiscal component of the decomposition presented in Section 2, that is, it multiplies the DBGG coefficient estimated over the full sample by the observed level of gross debt in each month. Graph 6 illustrates the resulting trajectory:

GRAPH 6. TREND OF THE FISCAL COMPONENT IN THE INTEREST RATE PREMIUM (IN P.P.)



Prepared by: IFI.

The fiscal component's trajectory shows four main phases. In the pre-crisis period, between 2011 and 2013, the estimated contribution remains relatively stable, at around 2.10 p.p. From 2014 onward, a gradual increase is observed, tracking the rise in the DBGG, with an average contribution of 2.41 p.p. between 2014 and 2016. This movement intensifies during the pandemic, when the component reaches a peak of 3.48 p.p. in 2020–2021, reflecting the sharp increase in gross debt over the period, associated with emergency fiscal expansion and the drop in GDP, which also raised the debt-to-GDP ratio.

Between 2022 and 2024, the contribution partially declines, tracking the reduction in the DBGG, but remains above the levels observed at the beginning of the sample. In the final part of the period, it rises again, reaching an average of 3.16 p.p. over the twelve months through August 2026, higher than that recorded during the 2014–2016 crisis.

Concentration of the Fiscal Effect at the Long End of the Curve

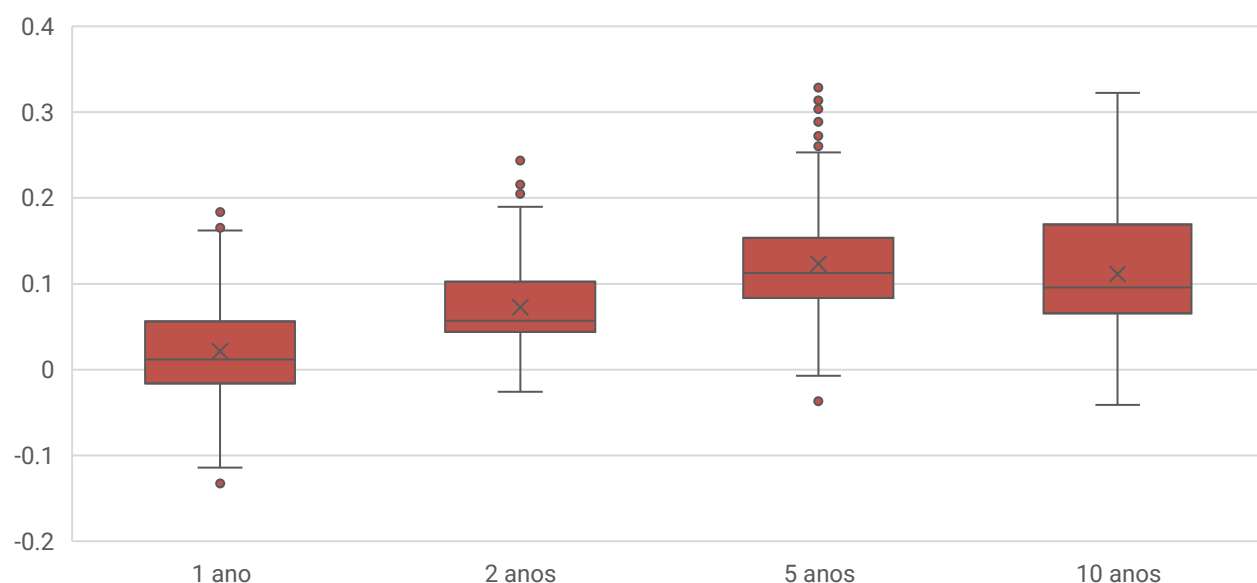
Up to this point, the analysis has focused on the five-year risk premium, used as the reference in the regressions and decomposition exercises presented in the previous sections. One advantage of the ACM methodology, however, is that it allows the risk premium to be estimated at different points along the term structure. This makes it possible to investigate whether the association between the fiscal position and the premium identified at the five-year horizon is specific to that maturity or follows a systematic pattern across the yield curve.

At shorter tenors, rate formation tends to more strongly reflect the expected path of monetary policy and cyclical conditions. As maturity lengthens, the uncertainty associated with the future trajectory of public debt, the capacity to generate primary balances, and the public sector's refinancing conditions tends to gain importance. Thus, if fiscal risk is predominantly persistent in nature, its association with the premium would be expected to be more pronounced at longer maturities. This pattern would be consistent with the

interpretation that the fiscal position mainly affects the compensation investors require to bear risks related to the medium- and long-term fiscal trajectory, rather than only current economic policy conditions.

To evaluate this hypothesis, the second exercise re-estimates Equation 2 in rolling 60-month windows, separately, for the 1-, 2-, 5-, and 10-year premiums, and summarizes the distribution of the premium's sensitivity to the DBGG obtained across 169 windows at each tenor. Graph 7 presents the results.

GRAPH 7. SENSITIVITY OF THE RISK PREMIUM TO THE FISCAL VARIABLE, BY TENOR (IN P.P.; 1, 2, 5, AND 10 YEARS)



Source: Prepared by IFI, based on Equation 2, re-estimated in rolling 60-month windows for the 1-, 2-, 5-, and 10-year tenors of the risk premium (169 estimates per tenor, windows ending between January 2012 and August 2026). Boxes bounded by the 1st and 3rd quartiles, center line at the median, "x" indicating the mean; whiskers extending up to 1.5 times the interquartile range; points beyond the whiskers are outliers.

Each box summarizes, for a specific tenor of the risk premium's term structure, the distribution of the estimated DBGG coefficients across the 169 rolling five-year windows. The higher the median of the distribution, the greater the premium's typical sensitivity, at that maturity, to the fiscal position. The height of the box, corresponding to the interval between the first and third quartiles, indicates the dispersion of the central 50% of the estimates over time, while the whiskers and the outlying points reflect the additional range and the presence of outliers.

The distribution of the coefficients suggests that the premium's sensitivity to the fiscal component increases as one moves along the term structure. The median rises from 0.007 at the one-year tenor to 0.054 at two years and 0.112 at five years, remaining at a similar level at the 10-year tenor.

The dispersion also increases with maturity. The interquartile range widens from 0.063 at the one-year tenor to 0.098 at 10 years, while the highest values observed across the rolling windows are concentrated at the 5- and 10-year tenors. In the most recent windows of the

sample, corresponding to 2025 and 2026, the coefficients reach approximately 0.329 and 0.337 at these two tenors, respectively.

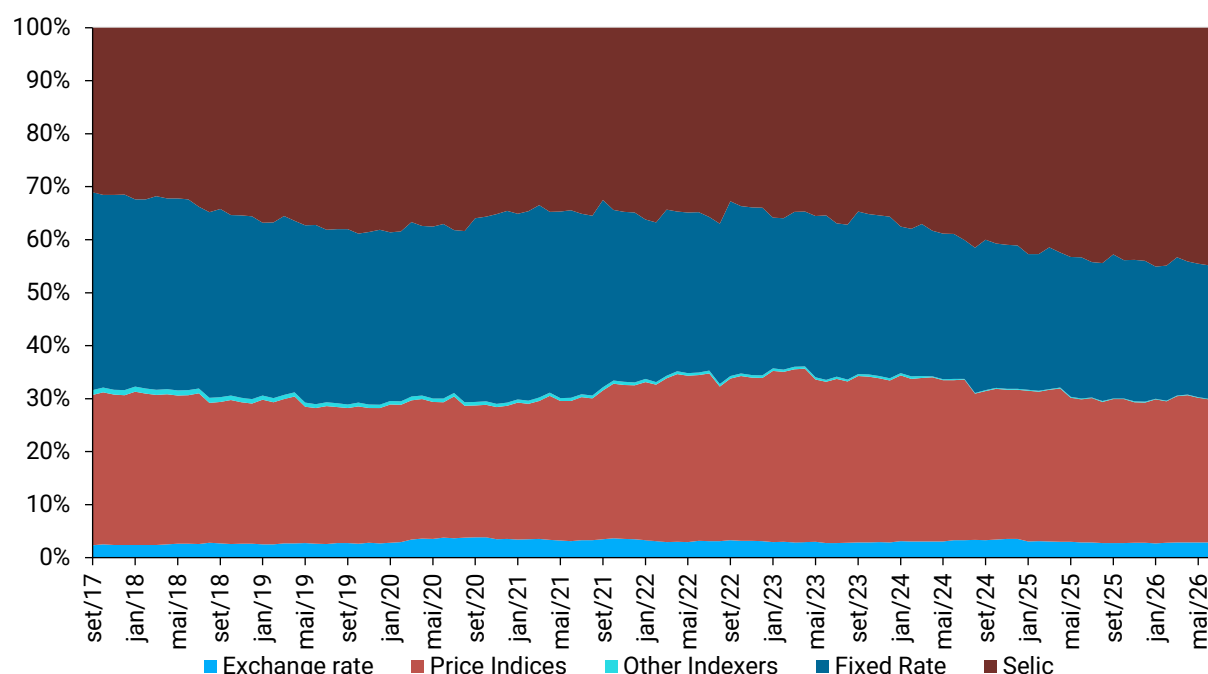
This result indicates that the influence of the fiscal variable is not uniform along the yield curve. Sensitivity is relatively low at shorter maturities and becomes more pronounced at longer tenors. This pattern is consistent with the nature of fiscal risk, whose transmission tends to occur mainly through expectations about solvency, the future trajectory of debt, and the need for additional compensation to hold positions in longer-duration securities.

This pattern is also consistent with the results from Section 3, in which the fiscal component proved relevant to the formation of the premium. The evidence by tenor adds an important dimension to this result by showing that the relationship is concentrated mainly at longer maturities.

The Composition of Public Debt

The previous exercises showed that the fiscal position is associated with the formation of the risk premium, with a more pronounced effect at longer horizons. There is, however, a second relevant channel in the interaction between fiscal policy and interest rates: the composition of the public debt stock itself. The greater the share of securities remunerated directly by the Selic rate, the greater the sensitivity of the cost of debt to monetary policy decisions, causing increases in the policy rate to be transmitted more quickly to interest expenditure and, consequently, to debt dynamics. Graph 8 presents this change in composition in recent years.

GRAPH 8. COMPOSITION OF FEDERAL PUBLIC DEBT BY INDEXER



Source: National Treasury Secretariat (STN). Prepared by: IFI.

This mechanism has gained importance in the recent period, during which the composition of the Federal Public Debt has shown a growing share of Selic-indexed securities. The share associated with this indexer rose from 35.7% in December 2023 to 41.1% in December 2024, 44.0% in December 2025, and 46.4% in July 2026, the sharpest single-month jump in the entire recent series (+1.5 p.p. between June and July). By contrast, the share of fixed-rate securities fell from 30.5% to 23.5% over the same period, while the share indexed to price indices went from 30.6% to 27.2%.

This change in composition increases the exposure of the cost of debt to changes in the policy rate. Since Selic-indexed securities incorporate monetary policy decisions more directly and immediately, the increase in their share means that monetary tightening cycles are transmitted more intensely to the carrying cost of public debt.

Moreover, the results reinforce an already well-known mechanism³⁸ of feedback between interest rates and the fiscal position. Higher interest rates raise interest expenditure and contribute to the expansion of debt itself. The recent increase in the share of Selic-indexed securities amplifies this second channel, by making a larger portion of the stock directly sensitive to changes in the policy rate. Thus, debt and interest rates can act in a mutually reinforcing way, although the exercises presented here do not, on their own, establish the dynamic causality between these channels.

Concluding Remarks

The decomposition of the five-year nominal rate indicates that the persistence of high interest rates in Brazil cannot be attributed solely to the current conduct of monetary policy. Although the accumulated expectation of the Selic rate explains a significant share of the level of the long rate, the risk premium accounts for most of its volatility and shows a statistically significant association with the fiscal position. This relationship becomes more pronounced at the 5- and 10-year tenors, suggesting that the fiscal component acts mainly on the compensation required to hold longer-maturity positions.

The estimated trajectory of this component reinforces this interpretation. The DBGG's contribution to the level of the premium reached approximately 3.16 p.p. in the twelve months through August 2026, above the average of 2.41 p.p. observed during the 2014–2016 fiscal crisis and close to the 3.48 p.p. peak recorded during the pandemic. This result is consistent with a channel associated with perceptions of debt sustainability: the longer the bond's horizon, the greater the relevance attached to the future trajectory of debt, the capacity to generate primary balances, and the public sector's refinancing conditions.

Added to this mechanism is the recent change in debt composition. Between December 2023 and July 2026, the share of Selic-indexed securities rose from 35.7% to 46.4% of the stock, thereby increasing the sensitivity of the cost of debt to monetary policy decisions. As

³⁸ See, for example, Blanchard (2004).

a result, monetary tightening cycles are transmitted more quickly to interest expenditure and, consequently, to debt dynamics. The exercises in this note do not allow us to identify the direction or causal magnitude of this interaction in isolation. However, they point to a closer relationship between monetary conditions, debt composition, and the fiscal premium.

While inflationary, external, exchange rate, and institutional factors remain relevant to the country's long-term financing costs, the results indicate that the fiscal position is a statistically significant and economically meaningful component of the risk premium. Thus, a sustained reduction in the cost of financing the Brazilian economy requires that the fiscal dimension be explicitly incorporated into the debate on high interest rates.

References

ADRIAN, Tobias; CRUMP, Richard K.; MOENCH, Emanuel. Pricing the term structure with linear regressions. *Journal of Financial Economics*, v. 110, n. 1, p. 110-138, 2013.

ARAUJO, Gustavo Silva; VICENTE, José Valentim Machado; GAGLIANONE, Wagner Piazza. *Determinants of the risk premium in Brazilian nominal interest rates*. Brasília, DF: Banco Central do Brasil, 2025.

ARIDA, Pérsio; BACHA, Edmar Lisboa; LARA-RESENDE, André. Credit, interest, and jurisdictional uncertainty: conjectures on the case of Brazil. In: GIAVAZZI, Francesco; GOLDFAJN, Ilan; HERRERA, Santiago (org.). *Inflation targeting, debt, and the Brazilian experience, 1999 to 2003*. Cambridge, MA: MIT Press, 2005.

BAI, Jushan; PERRON, Pierre. Estimating and testing linear models with multiple structural changes. *Econometrica*, v. 66, n. 1, p. 47-78, 1998.

BANCO CENTRAL DO BRASIL. Determinantes do prêmio de risco nas taxas nominais brasileiras. In: BANCO CENTRAL DO BRASIL. *Relatório de Política Monetária*. Brasília, DF: Banco Central do Brasil, jun. 2025. p. 69-74.

BLANCHARD, Olivier. *Fiscal dominance and inflation targeting: lessons from Brazil*. Cambridge, MA: National Bureau of Economic Research, 2004. (NBER Working Paper, n. 10389).

BLANCHARD, Olivier; CHOURAQUI, Jean-Claude; HAGEMANN, Robert P.; SARTOR, Nicola. The sustainability of fiscal policy: new answers to an old question. *OECD Economic Studies*, n. 15, 1990.

CARTER, Thomas J.; KAMBER, Güneş; OTTEN, Julia. *How to design and review inflation targets in emerging market and developing economies*. Washington, DC: International Monetary Fund, 2026. (n. 2026/004).

GONÇALVES, Fernando M.; HOLLAND, Márcio; SPACOV, Andrei D. Can jurisdictional uncertainty and capital controls explain the high level of real interest rates in Brazil? Evidence from panel data. *Revista Brasileira de Economia*, v. 61, n. 1, p. 49-76, 2007.

HAUSMANN, Ricardo. *In search of the chains that hold Brazil back*. Cambridge, MA: Harvard Center for International Development, 2008. (Working Paper, n. 180).

HOLLAND, Márcio. *Taxa de juros no Brasil: caminhos para o Brasil conviver com taxas de juros civilizadas*. [S. l.]: Alta Cult, 2026.

KLEIN, G. Um terceiro fator para os juros altos. *Folha de S.Paulo*, 4 set. 2026.

PESSÔA, Samuel. Os juros elevados brasileiros. *Blog do IBRE*, 26 ago. 2026.

SEGURA-UBIERGO, Alex. *The puzzle of Brazil's high interest rates*. Washington, DC: International Monetary Fund, 2012. (IMF Working Paper, WP/12/62).

VESCOVI, Ana Paula. O custo Brasil, para além dos juros. *Folha de S.Paulo*, 21 fev. 2026.

Court-Ordered Debt Payments in the Federal Budget

Dalmo Palmeira, Gustavo Queiroz and Tallita Andrade

Introduction

In recent years, expenditures on court-ordered debt payments (*precatórios*) and Small Value Requests (RPs) have come to occupy an important space in federal public spending. They have become a highly relevant variable in the discussion of the federal government's fiscal balance.

It is no coincidence that this issue has prompted the enactment of three Constitutional Amendments (ECs) and three direct actions for the declaration of unconstitutionality (ADIs) over the past five years. The Constitutional Amendments were attempts to address how these expenditures fit within the fiscal space of the federal budget: (i) Constitutional Amendment No. 113; (ii) Constitutional Amendment No. 114; and (iii) Constitutional Amendment No. 136. However, given the complexity of their rules, the constitutionality of these amendments was partially challenged through ADIs 7047, 7064, and 7873, before the Federal Supreme Court (STF), with the first two ADIs relating to ECs 113 and 114, and ADI 7873 relating to EC 136/2025.

It is also worth noting that this issue is highly relevant to the discussion of subnational public finances. In fact, the volume of court-ordered debt payments owed by subnational entities — as shown by the Annual Court-Ordered Debt Payment Map (Mapa Anual de *Precatórios*), maintained by the National Council of Justice (CNJ) — was, as of December 31, 2025, almost four times larger than the volume of federal court-ordered debt payments. This figure alone indicates how important this issue also is for states and municipalities. Accordingly, the debate on this topic should become crucial for the analysis of public finances, both federal and subnational, particularly for those entities with a larger stock of court-ordered debt payments.

This analysis will focus solely on the impact of court-ordered debt payment expenditures on the federal budget, showing their trajectory and growth outlook, along with the resulting fiscal impacts on the federal budget.

What Are *Precatórios* and RPs?

Under Article 100 of the Federal Constitution, *precatórios* are judicial payment orders owed by the Federal, State, Federal District, and Municipal Public Treasuries, arising from a court ruling. This means that they always represent amounts that a public entity must pay to someone as a result of having lost a lawsuit in which that entity was the defendant.

The amount of court-ordered debt payments to be disbursed under the 2027 federal budget is BRL 97.7 billion, according to the projections contained in the PLOA 2027.

Within the broader category of court-ordered debt payments, judicial claims related to debts of a subsistence nature (wages or social security benefits) and RPVs (Small Value Requests) – claims whose value, in the case of the Federal Government, does not exceed 60 times the minimum wage – receive differentiated treatment regarding payment priority. Under Article 100 of the Federal Constitution, these amounts must be paid within 60 days of the court ruling. In addition to this precedence rule, court-ordered debt payments of a subsistence nature owed to individuals aged 60 or older, persons with disabilities, or persons with serious illnesses, regardless of age, also receive payment precedence.

Table 12 below presents the different classifications of judicial claims brought against public entities and their implications in terms of preferential payment treatment.

TABLE 12. CLASSIFICATION OF STATE JUDICIAL DEBTS

Nomenclature	Characteristic	Treatment
1. RPV - Small Value Requests	Court rulings representing up to 60 times the minimum wage, in the case of the Federal Government	Must be paid within 60 days of the ruling
2. Court-Ordered Debt Payments of a Subsistence Nature	Court rulings arising from claims related to wages or social security benefits	Receive differentiated treatment
2a. Court-Ordered Debt Payments of a Subsistence Nature - Elderly	Court-ordered debt payments of a subsistence nature owed to individuals over 60 years of age	Receive payment precedence, up to a limit of 180 times the minimum wage
2b. Court-Ordered Debt Payments of a Subsistence Nature - Persons with Disabilities or Serious Illnesses	Court-ordered debt payments of a subsistence nature owed to persons with disabilities or persons with serious illnesses, regardless of age	Receive payment precedence, up to a limit of 180 times the minimum wage
2c. Court-Ordered Debt Payments of a Subsistence Nature - Other	Other Court-ordered debt payments of a subsistence nature not falling under the above situations	The general rule for Court-Ordered Debt Payments of a Subsistence Nature applies: receive differentiated treatment
3. Other Court-Ordered Debt Payments	Court-ordered debt payments not of a subsistence nature	Payment by the end of the following fiscal year, in chronological order.

Source: Article 100 of the Federal Constitution

According to Table 12, judicial debts against the State can be organized into three broad groups: (i) Small Value Requests (RPVs), claims whose total value does not exceed 60 times the minimum wage; (ii) court-ordered debt payments of a subsistence nature, that is, those arising from rulings on wages or social security benefits, which therefore receive differentiated treatment in the payment process; and (iii) other court-ordered debt payments with no payment precedence criterion.

The second group also contains a further subdivision, giving precedence to court-ordered debt payments of a subsistence nature when their beneficiaries are individuals over 60 years of age, persons with serious illnesses, or persons with disabilities of any age.

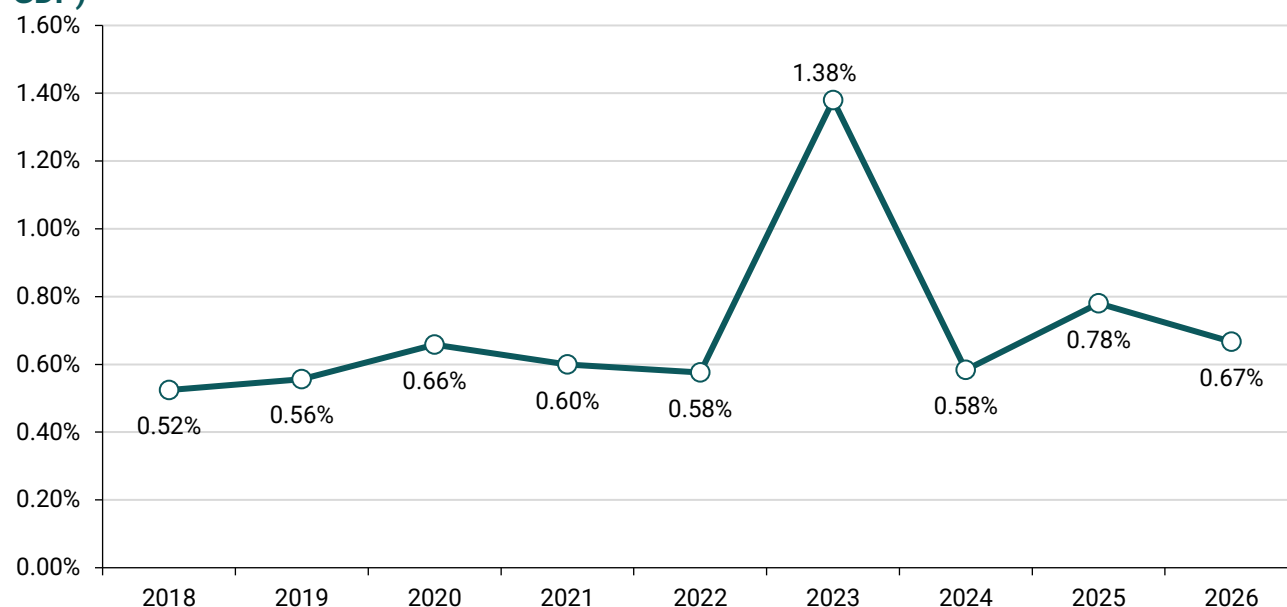
Trajectory of Court-Ordered Debt Payment Values in the Federal Budget

As noted above, this topic has been the subject of significant legislative and judicial changes in recent years, which altered the rules governing this type of expenditure within a short span of time. This led to rapid swings in the amounts of court-ordered debt payments disbursed and in the stock of unpaid amounts. Enacted while the Expenditure Ceiling (created by Constitutional Amendment No. 95, of 2016) was still in effect, Constitutional Amendments 113 and 114, of 2021, created a sub-ceiling for court-ordered debt payment disbursements, before being struck down by the Federal Supreme Court's ruling in direct action for the declaration of unconstitutionality (ADI) 7064.

EC No. 136, of 2025, in turn, already taking into account the terms of ADI 7064, introduced a payment schedule aimed at regularizing the stock of court-ordered debt payments over time. However, as with the dynamics of the previous ECs, it still implies, to some extent, the generation of a growing stock of unpaid court-ordered debt payments.

Graph 9 shows the trajectory of court-ordered debt payment disbursements in recent years, as a share of GDP, based on budget execution data (payment basis) from the Integrated Planning and Budget System (SIOP).

GRAPH 9. FEDERAL COURT-ORDERED DEBT PAYMENTS DISBURSED, 2018 TO 2026 (% OF GDP)



Source: SIOP. Prepared by: IFI

Note: for 2026, the execution figures correspond to the amount accumulated through September 9, 2026.

Graph 9 above shows the growth in the amounts of federal court-ordered debt payments disbursed over the period analyzed, as a share of GDP. Between 2018 and 2022,

disbursements grew modestly, rising from 0.5% to 0.6% of GDP. In 2023, there was an outlier disbursement of BRL 151.0 billion, equivalent to 260% of the amount paid in the previous year and 1.4% of that year's GDP. This surge in disbursements is a direct effect of the Federal Supreme Court's (STF) ruling on ADI 7064, which partially upheld the challenge to the constitutionality of the rules established by Constitutional Amendments 113 and 114.

As a result of this ruling, the entire accumulated stock from previous years under the rules of the aforementioned Constitutional Amendments was paid in 2023, along with all the court-ordered debt payments already scheduled for payment that year under the general rule, as well as advance payments of amounts related to fiscal year 2024.

When assessing the impact of these Constitutional Amendments on the execution of court-ordered debt payments, no significant change can be observed in the pace of growth of this expenditure during the years the rules were in effect, that is, 2021 and 2022. Despite the containment rules established by these Amendments, observed expenditure remained stable at 0.6% of GDP. Despite this stability in the pace of disbursement, the stock of court-ordered debt payments grew over the period. Naturally, had these Constitutional Amendments not been approved, the growth in court-ordered debt payment expenditure would have been more pronounced.

Lastly, the period of court-ordered debt payment execution from 2024 to 2026 shows a new growth phase, at a faster pace than in the pre-2023 period. In this sense, average disbursements, which stood at 0.6% of GDP between 2018 and 2022, rose to 0.7% of GDP between 2024 and 2026. In addition, the 2026 execution figure is still incomplete, as it reflects partial execution data through early September. The 2026 figure in Graph 9 considers payments made through September 9, 2026, with more than three months of execution still remaining. In the 2026 Budget, the total amount of resources reserved for this type of expenditure (current appropriation) stands at BRL 122.3 billion, which represents the potential execution by the end of the current fiscal year.

In addition to the data shown in Graph 9, the PLOA 2027 includes the amounts projected for court-ordered debt payment disbursements in the coming fiscal year. The appropriations earmarked in the 2027 budget for court-ordered debt payments total BRL 97.7 billion, BRL 24.6 billion less than the current appropriation in the 2026 budget. Based on the recent behavior of this expenditure, it is possible that this amount will not be sufficient to cover court-ordered debt payments over the course of next year.

With regard to fiscal year 2027, the PLOA also provides that part of the appropriations for court-ordered debt payments will not be released for execution at the start of the year. Of the total amount, BRL 33.7 billion was budgeted in the PLOA 2027 using so-called contingent revenue. This revenue stems from the issuance of public debt securities in excess of the parameter set out in Article 167, Section III, of the Federal Constitution, known as the Golden Rule. Under this rule, the amount of credit operations in the budget cannot exceed the volume of capital expenditures. If this occurs, the portion exceeding that limit is recorded

as contingent expenditure, subject to subsequent approval by the National Congress, through a specific bill, before it can be released for actual execution.

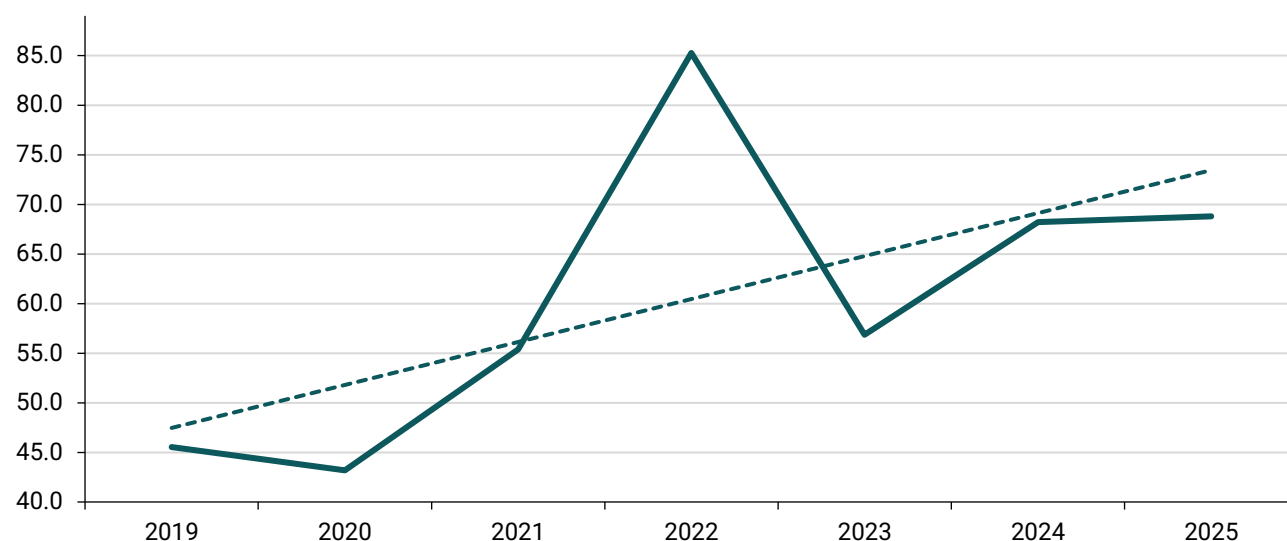
In the case of the PLOA 2027, the amount exceeding this limit was BRL 414.1 billion, of which BRL 33.7 billion is allocated to court-ordered debt payments. As a result, of the total funds budgeted for court-ordered debt payments, BRL 64.0 billion is associated with non-contingent revenue, which can be used without the need for subsequent authorization from Congress.

Trend in the Stock of Federal Court-Ordered Debt Payments

Although court-ordered debt payments disbursed over the period analyzed totaled close to BRL 650 billion, the stock of outstanding court-ordered debt payments continued to grow, according to data from the Annual Court-Ordered Debt Payment Map³⁹, maintained by the National Council of Justice (CNJ). This shows that neither the containment measures introduced through the constitutional amendments, nor the special-regime payments made in 2023 under the terms agreed upon in the ADI 7064 ruling, were able to ease the pressure on government cash flow or change the outlook for growth in court-ordered debt payment expenditure in the coming years.

Graph 10 below shows the trend in the stock of court-ordered debt payments in recent years, according to data from the Annual Court-Ordered Debt Payment Map, maintained by the National Council of Justice (CNJ), which reports the position of this stock as of December 31 of each year.

GRAPH 10. BALANCE OF FEDERAL COURT-ORDERED DEBT PAYMENTS, 2019 TO 2025 (BRL BILLIONS, NOMINAL VALUES)



Source: Annual Court-Ordered Debt Payment Map, CNJ. Prepared by: IFI

³⁹ Available at: <https://paineisanalytics.cnj.jus.br/single/?appid=24bb0aae-4341-48e7-b3b5-3606607894c4&sheet=60a7540d-d58d-43af-a15e-fa179c7a5233&lang=pt-BR&opt=ctxmenu,currsel>

The data on the stock of court-ordered debt payments reported by the CNJ point to continuous growth in its value, despite the steady pace of disbursements. This means that, despite all efforts to manage this expenditure, particularly the increased pace of debt settlement, the balance continues to grow. In the historical series of the court-ordered debt payment balance, a marked decline can be observed in 2023, largely due to the record disbursement of BRL 151 billion that occurred that year.

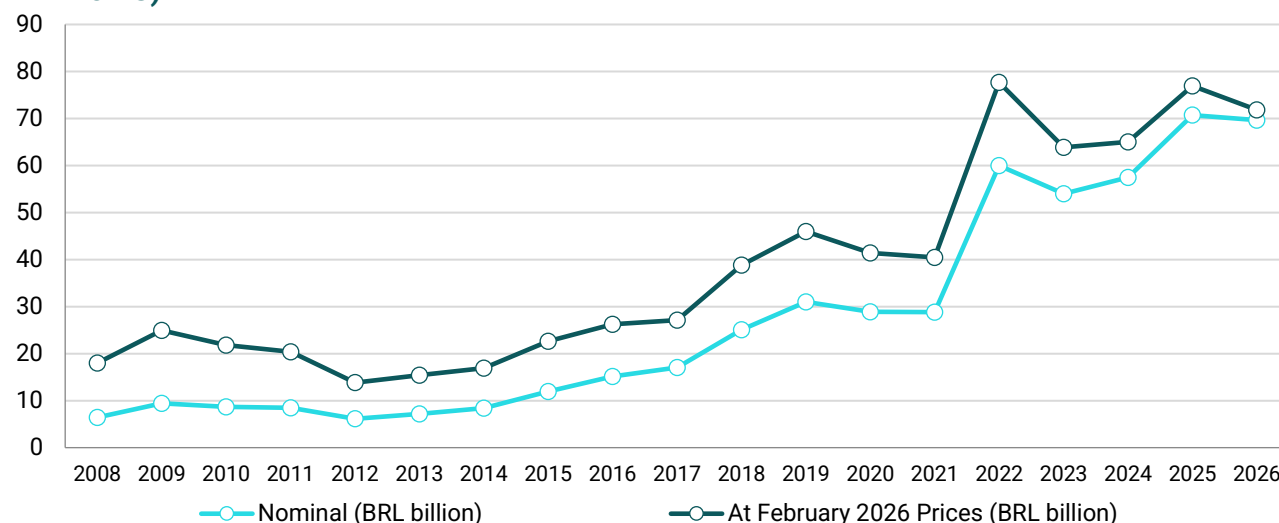
Thus, it becomes clear that the dynamics of court-ordered debt payment expenditure at the federal level are not related to a backlog in disbursements. Although the volume of payments is high and growing, the stock of court-ordered debt payments has still shown a rising accumulation trend in recent years. From the analysis of this dynamic between the volume of disbursements and the balance of the court-ordered debt payment stock, it can be inferred that there is a prior variable that needs to be examined to better understand the growth of this expenditure in the federal budget. This prior variable is the volume of newly issued court-ordered debt payments, which we turn to in the next section.

Growth Rate in the Issuance of Court-Ordered Debt Payments

The inclusion of court-ordered debt payments in the federal budget follows notification from all higher courts, the Federal Courts, and the state courts to the federal Executive Branch. The federal Budget Guidelines Laws (LDOs) set out, year by year, the procedures for the Judiciary to submit information on court-ordered debt payments issued through the month of February each year, pursuant to Article 100, paragraph 5, of the Federal Constitution. The set of court-ordered debt payments thus issued and submitted then make up the amount to be paid in the following fiscal year.

Graph 11 below presents, in current and constant terms, the amounts of federal court-ordered debt payments, in BRL billions, issued by the Judiciary over the period from 2008 to February 2026, showing the year-by-year dynamics in the volume of newly issued court-ordered debt payments.

GRAPH 11. FEDERAL COURT-ORDERED DEBT PAYMENTS ISSUED, 2008 TO 2026 (BRL BILLIONS)



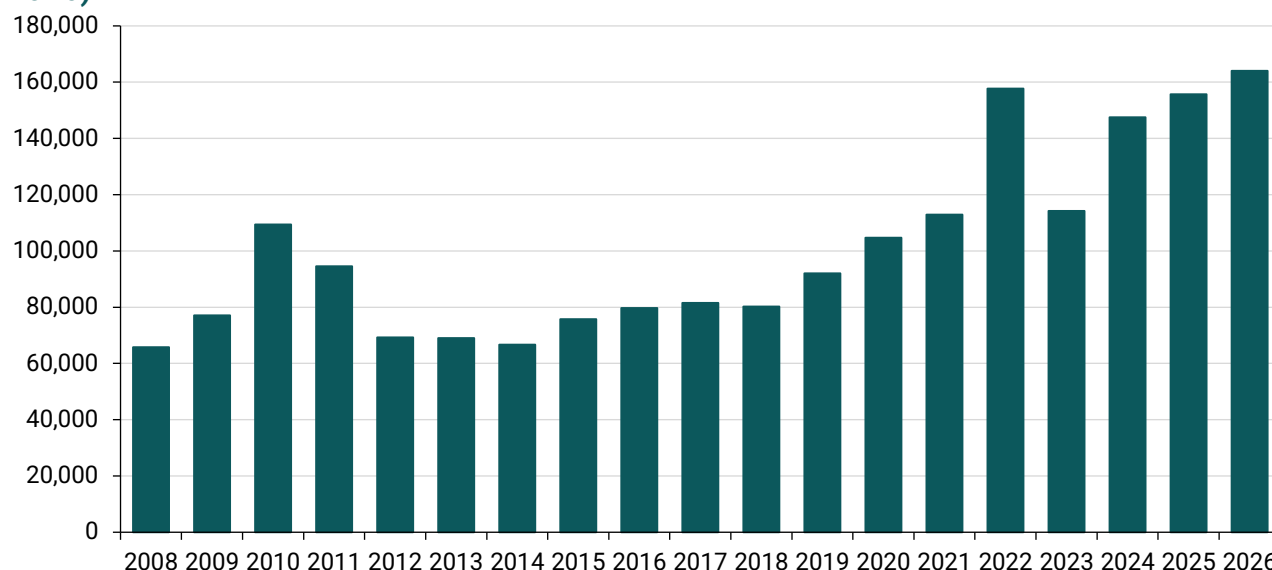
Source: Court-Ordered Debt Payment Panel, Ministry of Planning and Budget (MPO)⁴⁰

Graph 11 shows an acceleration in the accumulated value of newly issued court-ordered debt payments between 2012 and 2019, followed by a period of stabilization in 2020 and 2021. However, what stands out is the shift to a new level in the issuance of court-ordered debt payments starting in 2022, which has persisted to this day. It appears that, to a large extent, both the acceleration in the volume of disbursements and the growth in the stock of court-ordered debt payments do not stem from a backlog in payments, but rather are a consequence of the acceleration in the volume of court-ordered debt payments issued. This growth dynamic in new court-ordered debt payments occurs not only in terms of their value, but also in terms of the number of court-ordered debt payments issued over the same period.

Graph 12 below presents the number of federal court-ordered debt payments issued by the Judiciary, also over the period from 2008 to 2026, showing the year-by-year dynamics of newly issued court-ordered debt payments.

⁴⁰ Available at: <https://www.gov.br/planejamento/pt-br/assuntos/orcamento/precatorios-content/painel-precatorios>.

GRAPH 12. NUMBER OF FEDERAL COURT-ORDERED DEBT PAYMENTS ISSUED (2008 TO 2026)



Source: Court-Ordered Debt Payment Panel, Ministry of Planning and Budget (MPO)⁴¹

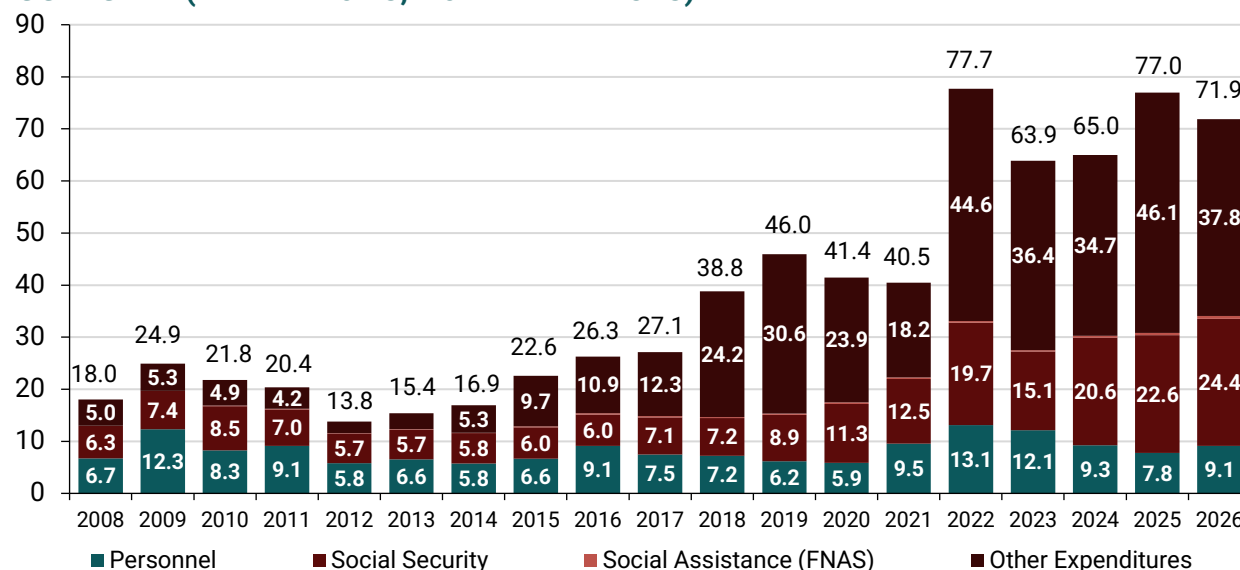
Graph 12 above shows that the trend in the number of court-ordered debt payments over the period analyzed follows the same dynamic observed in the previous graph. There is continued growth between 2012 and 2021 and a shift to a higher level in the following years. It is therefore clear that not only were the amounts of court-ordered debt payments issued higher in recent years, but there was also an increase in judicial output over the period, which also helps explain the growing pressure of court-ordered debt payments on federal public accounts.

When the aggregates that make up the volume of issued court-ordered debt payments are broken down by type, it becomes clear where the recent growth is concentrated. Graph 13 below presents, in nominal terms, the amounts of federal court-ordered debt payments issued by the Judiciary over the period from 2008 to 2026, broken down by the aggregates that compose them – Personnel, Social Security, Social Assistance, and Other⁴².

⁴¹ Available at: <https://www.gov.br/planejamento/pt-br/assuntos/orcamento/precatorios-content/painel-precatorios>

⁴² Classified under "Other" are court-ordered debt payments related to FUNDEF (21.7%), price-control actions arising from intervention in the economic domain (13.7%), expropriation for agrarian reform purposes (INCRA) (6.1%), public debt securities (2.7%), and SUS payment table adjustments (1.9%), among others.

GRAPH 13. FEDERAL COURT-ORDERED DEBT PAYMENTS ISSUED, BY EXPENDITURE AGGREGATE (BRL BILLIONS, NOMINAL VALUES)



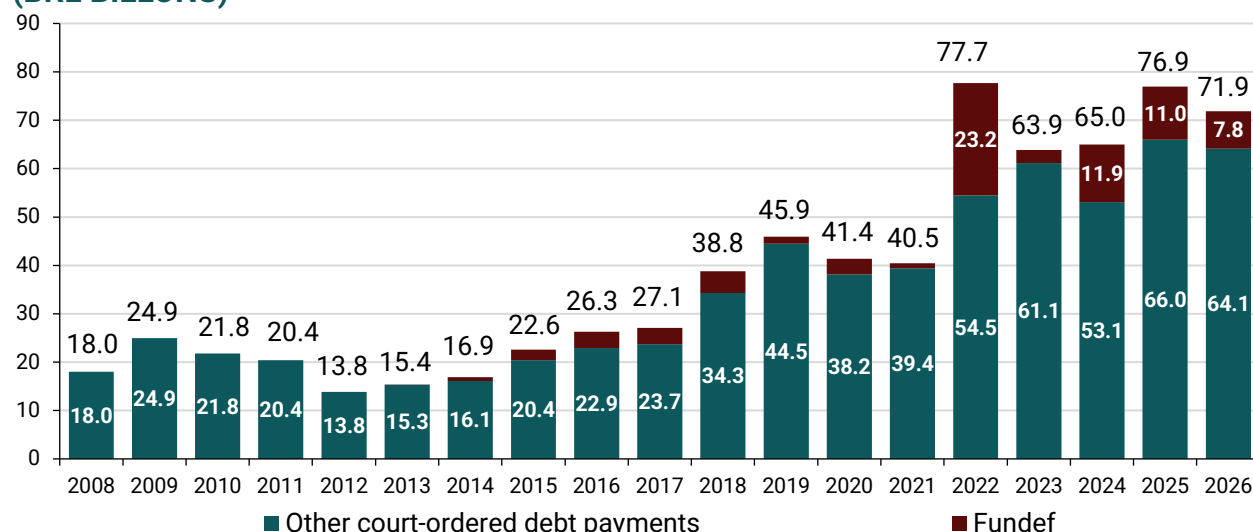
Source: Court-Ordered Debt Payment Panel, Ministry of Planning and Budget– MPO⁴³

Examining the composition of amounts approved in recent years reveals that the share of the "Other" component has grown, along with court-ordered debt payments of a social security nature, albeit to a lesser extent. Together, these two components have become predominant in the composition of court-ordered debt payment amounts, accounting for a larger share of the total, particularly from 2022 onward. Throughout recent debates on court-ordered debt payments, particularly during the passage of Constitutional Amendments 113/2021 and 114/2021, there was much discussion about the extent to which payments related to the former Fund for the Maintenance and Development of Basic Education and Valorization of Teaching (FUNDEF) contributed to the growth of total court-ordered debt payments.

Graph 14 below presents, in nominal terms, the amounts of federal court-ordered debt payments over the same period as the previous graphs, specifically identifying those arising from judicial claims related to the former FUNDEF, as compared with other court-ordered debt payments.

⁴³ Available at: <https://www.gov.br/planejamento/pt-br/assuntos/orcamento/precatorios-content/painel-precatorios>

GRAPH 14. COURT-ORDERED DEBT PAYMENTS – FUNDEF-RELATED AND OTHER (BRL BILLIONS)



Source: Court-Ordered Debt Payment Panel, Ministry of Planning and Budget – MPO⁴⁴

Looking at Graph 14, it is clear that, historically, FUNDEF-related court-ordered debt payments accounted for a small share of the total through 2021. In 2022, a very sharp concentration of FUNDEF-related court-ordered debt payments occurred: BRL 23.2 billion was issued on this topic alone. Although there was growth in the share of FUNDEF-related court-ordered debt payments, this does not fully explain the shift to a higher level in this expenditure that has persisted from 2022 to the present day.

Concluding Remarks

The analysis of the recent trajectory of court-ordered debt payment expenditure in the federal budget allows for some relevant conclusions for the fiscal debate.

First, a structural shift to a higher level of this expenditure is observed starting in 2022, both in disbursements and in the stock of court-ordered debt payments, as well as in the issuance of new court-ordered debt payments. Average disbursements jumped from around BRL 48.0 billion (2018–2022), approximately 0.56% of GDP, to BRL 86.4 billion (2024–2026), approximately 0.70% of GDP. This shows that this is not a cyclical fluctuation, but a new level of expenditure that must be taken into account in budget planning for the coming years.

Second, successive attempts to regulate this expenditure through constitutional means – Constitutional Amendments 113/2021, 114/2021, and 136/2025 – have failed to contain its growth. This is either because these rules were partially overturned by the Federal Supreme Court, as in the case of ADI 7064, or because the containment rules addressed the flow of disbursements rather than the underlying causes of the problem. As shown above, the growth in the stock of court-ordered debt payments does not stem from a backlog in

⁴⁴ Disponível no link <https://www.gov.br/planejamento/pt-br/assuntos/orcamento/precatorios-content/painel-precatorios>

disbursements, which grew consistently over the period, but rather from an acceleration in the issuance of new court-ordered debt payments in both value and number, particularly from 2022 onward.

Third, the composition of these new court-ordered debt payments shows that this growth cannot be explained by a single factor. Although FUNDEF-related court-ordered debt payments played a significant role – particularly in 2022, when they accounted for BRL 23.2 billion of that year's issuance volume – they do not account for the entire shift to a higher level observed since then, which continues to be driven mainly by the "Other" and Social Security aggregates.

Lastly, the figures in the PLOA 2027 raise an additional warning sign. The appropriation provided for (BRL 97.7 billion) is about BRL 25 billion lower than the current 2026 appropriation (BRL 122.3 billion), in a context of historically rising expenditure. Adding to this is the fact that a significant portion of this amount (BRL 33.7 billion) is contingent on approval, by the National Congress, of a specific bill tied to the excess issuance of public debt securities relative to the Golden Rule – which introduces additional uncertainty about the actual availability of funds over the course of the year.

Against this backdrop, the main point of attention for fiscal policy lies not only in how existing court-ordered debt payments are financed or scheduled, but also in understanding and, to the extent possible, mitigating the factors that have been driving the acceleration in the issuance of new court-ordered debt payments since 2022. This is key to preventing new constitutional containment rules from once again providing only temporary relief for a structural problem. Additionally, since the stock of court-ordered debt payments held by subnational entities is now nearly four times greater than that held by the Federal Government, the same growth dynamic observed at the federal level – and its underlying causes – warrants specific investigation with regard to states and municipalities.

IFI PROJECTIONS

SHORT TERM

IFI Projections	2026			2027		
	Aug/26	Sep/26	Comparison	Aug/26	Sep/26	Comparison
GDP – real growth (% p.a.)	1.7	2.0	▲	2.0	1.8	▼
GDP – nominal (BRL billion)	13,432.1	13,667.1	▲	14,244.8	14,533.4	▲
IPCA – year-to-date (%)	3.9	5.0	▲	3.5	4.0	▲
Exchange rate – end of period (BRL/USD)	5.5	5.2	▼	5.5	5.2	▼
Employment – growth (%)	0.8	1.1	▲	0.5	0.7	▲
Wage bill – growth (%)	3.6	5.1	▲	2.7	3.4	▲
Selic – end of period (% p.a.)	12.0	14.0	▲	10.5	12.0	▲
Ex-ante real interest rates (% p.a.)	7.0	7.5	▲	6.2	5.5	▼
Consolidated Public Sector Primary Balance (% of GDP)	-0.7	-0.5	▲	-1.3	-0.7	▲
of which central government	-0.7	-0.4	▲	-1.3	-0.6	▲
Net Nominal Interest (% of GDP)	7.9	8.6	▲	7.5	8.5	▲
Nominal Balance (% of GDP)	-8.6	-9.0	▼	-8.8	-9.2	▼
General Government Gross Debt (% of GDP)	82.7	82.5	▼	86.2	86.4	▲



Federal Senate Translation and Interpretation Service – SETRIN

Angela Silva Brandão (translator)

Vitor Pinhal Landim (translation coordinator)

October 7, 2026.



 /ifibrasil

 @ifiBrasil

 @ifibrasil

 /company/ifibrasil

 /ifibrasil

 github.com/ifibrasil

ifi@senado.leg.br

+55 61 3303 2875

