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Fiscal Outlook Report

Executive Summary

This Fiscal Outlook Report is a new publication by the National Treasury Secretariat aiming to share relevant reflections for a better understanding of Brazil's current public finance outlook. With this purpose, it intends to expose the subject in a simple and accessible way, allowing evaluations that could foster public debate on the trajectory and sustainability of government accounts.

This Report, prepared by the Public Debt (SUDIP/STN) and Strategic Fiscal Policy Planning (SUPEF/STN) Undersecretariats, presents and discusses projections for the main Central Government fiscal variables. For this purpose, the publication consolidates the previous Brazilian Public Debt Forecasts Report with disaggregated projections for primary revenues and expenditures, as well as for the Primary Balance of the Central Government, for a period of ten years, based on the macroeconomic scenario provided by the Secretariat of Economic Policy of the Ministry of Economy (SPE/ME).

The outcomes, assumptions and methodologies displayed here do not reflect the view of the National Treasury in relation to current fiscal rules or government public policy choices, but rather the adoption of premises to support the elaboration of a medium-term fiscal scenario.

The fiscal scenario is presented in two parts. The first comprises the projections of revenues, expenses and primary balances. The second part, distributed in three sections, contains projections and analyses of public debt trajectory, including sensitivity to macroeconomic shocks, the expected evolution of the real cost and the required primary balance to stabilize debt in different scenarios.

Regarding the revenue projections, estimates indicate a decline compared to 2021 in Total Revenue to GDP and Net Revenue to GDP in the projected horizon, mainly due to the drop in income tax and industrial production tax (IR and IPI) collection, which, in turn, affects the Transfers by Revenue Sharing to subnational governments. From 2022 to 2031, we highlight the projected stability for Net Revenue, at an average of 17.6% of GDP.

On the primary expenditure side, it is projected to return to the downward trajectory, gradually reducing over the projected period until reaching 15.3% of GDP in 2031, about 3.3 percentage points of GDP below the 2021 level. This reduction is closely related to the evolution of expenditures subject to the Spending Cap, which decreases from 16.8% of GDP in 2021 to 14.0% of GDP in 2031, due to the fact that its correction factor is lower than GDP growth. In terms of its composition, we highlight the increase in the social secutiry, assistence and judicial claims shares in total expenditure over the period, which results in a compression of the space available for other expenses, especially discretionary spending.

As a result of the evolution of revenues and expenditures, we expect a improvement in the Central Government Primary Balance for the coming years, reverting from a deficit to a surplus in 2024. Compared to the official projections presented in the Budgetary Guidelines Law Project (PLDO) 2023, this reversal is anticipated in one year.

The baseline projections of this Report indicate that, at the end of 2022, General Government Gross Debt (GGGD) and Public Sector Net Debt (PSND) will reach 78.3% and 59.9% of GDP, respectively. Virtually stable between 2023 and 2024, the GGGD is expected to take a decreasing course in the following years, as primary surpluses in the public accounts are observed. The PSND follows a more persistent growth trend, being pressured for a longer time by the differential between the implicit interest rate and the GDP growth rate, presenting a decreasing trajectory only from 2028 onwards.

Although the current cycle of monetary policy translates into an increase in the short-term interest rates and, therefore, in the cost of public debt, such pressure is expected to be temporary. Moreover, the real cost of public debt has not risen to the same extent as the Selic interest rate in the short term, either by a significant portion of the debt not being indexed to Selic, rather reflecting the historical cost of borrowing in longer-term securities, or by the increase in nominal interest rates accompanying inflation itself. Also contributing to lower impacts on debt, the increase in interests tends to be partially offset by the effect of the GDP deflator.

If interest rates remain higher over an extended period of time, the risk of the GGGD and the PSND exceeding the baseline projections becomes greater, especially in the presence of unfavorable shocks to economic activity and in the absence of fiscal consolidation. Policies that favor sustained economic growth and keep interest rates lower for a longer period, combined with a responsible fiscal policy, are essential for preserving prudent debt levels. Although the GDP deflator can also influence the path of debt to GDP ratio, its higher level usually reflects higher inflation, which should not hold in the medium term.