



TESOURO NACIONAL

2022

December

Fiscal Outlook Report

Executive Summary

The main results of the Second Edition of the Fiscal Outlook Report are summarized in Table 1, which presents the medium-term fiscal projections for the Brazilian fiscal scenario. The projections, for a period of ten years, are based on the Primary Revenue and Expenditure Assessment Report for the 5th bimester of 2022 (as a reference for 2022 figures) and on the macroeconomic scenario provided on November 11th, 2022, by the Secretariat of Economic Policy of the Ministry of Economy (SPE/ME). The projections show a challenging scenario for fiscal policy in the next years and point to the need for fiscal consolidation and the proposition of fiscal rules capable of promoting public debt sustainability. In particular, the reference scenario presents consecutive primary deficits from 2023 to 2027, with an exception in 2026. This represents a significant deterioration compared to the last edition of this Report, which expected a return to primary surpluses as early as 2024.

Table 1 – Overview of the Fiscal Outlook (% of GDP)

Source: National Treasury Secretariat

Description	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public Sector Primary Balance	0.7	1.2	-1.1	1.0	-0.3	0.2	-0.0	0.7	1.1	1.2	1.5
Central Government	-0.4	0.4	-1.1	-0.9	-0.3	0.2	-0.0	0.8	1.1	1.3	1.5
Net Revenues	17.7	18.8	17.3	17.2	17.2	17.4	17.4	17.4	17.4	17.4	17.4
Total Expenditure	18.1	18.4	18.3	18.1	17.6	17.2	17.4	16.6	16.3	16.1	15.9
Regional Governments	1.1	0.7	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State Enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest Payments	5.0	6.0	7.1	6.3	6.0	6.0	6.0	5.8	5.6	5.5	5.4
Public Sector Overall Balance	-4.3	-4.8	-8.2	-7.2	-6.4	-5.9	-6.0	-5.0	-4.5	-4.2	-3.9
General Government Net Debt	60.2	59.0	61.0	63.2	65.0	66.2	67.6	68.2	68.3	68.4	68.2
General Government Gross Debt	78.3	73.7	75.7	77.3	78.4	79.1	80.2	80.1	79.6	78.6	77.6

The macroeconomic scenario indicates an economic recovery in the short term, with GDP growth above 2% per year throughout the period, despite the extension of the monetary tightening cycle, which results in a reduction of the SELIC rate only from 2024 onwards. This higher level of the SELIC rate is accompanied by an increase in inflation at the end of the horizon, when compared to the previous scenario, so that the real interest rate remains stable.

The primary revenues, in part influenced by this macroeconomic scenario, are heading towards a positive outcome in 2022, with an increase of 1.8 percentage points of GDP in Total Revenue and of 1.1 percentage points of GDP in Net Revenue, compared to 2021. However, a relevant part of this performance is explained by non-recurring events, such as revenues from Petrobras dividends and concessions resulting from the Eletrobras' privatization, or collections associated with the favorable commodities cycle, as observed in the evolution of the Corporate Income Tax (IRPJ) and the Social Contribution on Net Profits (CSLL), which may eventually cool down. At the same time, new tax exemptions, such as the 35% reduction in the Industrial Production Tax (IPI), with an impact of more than BRL 20.0 billion per year, added to the BRL 80.0 billion planned exemptions in the Budget Proposal for 2023 (PLOA 2023), lead to the accommodation of revenues in short term, with Net Revenues stabilizing at 17.4% of GDP by the end of the projections horizon, more than 1.4 percentage points of GDP below the 2022 projection.

On the primary expenditure side, given the current uncertainties regarding changes in the Expenditure Ceiling, the scenario incorporates an increase of BRL 100 billion in the Executive Branch's expenditure limit in 2023, which is carried over to the following years. This increase makes it possible to incorporate the changes under discussion in *Auxílio Brasil* (Brazilian cash transfer program), which will increase the expenditure with the program to BRL 175 billion per year. Except for changes in the *Auxílio Brasil*, all other mandatory expenses are projected considering current legislation, with no reforms or changes in policies. Furthermore, the scenario considers constant

discretionary expenses in real terms in the amount projected for 2023 (BRLR 120.6 billion). This means that the scenario does not comply with the Expenditure Ceiling from the moment that the available fiscal space is not enough to accommodate this amount of discretionary expenses. As a result, the expenditure shows a downward trend in the projection period, from 18.1% of GDP in 2021 to 15.9% of GDP in 2031. This reduction is closely related to the difference between the GDP and the total real expenditure average growth rates (2.25% and 1.3% per year, respectively).

The evolution of mandatory expenditures relies on individual trajectories of its main components. The biggest one is the expenditure with the General Social Security Scheme (RGPS), which goes from 8.0% of GDP in 2021 to 7.6% of GDP in 2031, but grows 2.2% per year in real terms. This growth pace accelerates from 2028, due to the demographic transition, reaching 2.9% in 2031. The payroll, in turn, falls more sharply, from 3.7% of GDP in 2021 to 2.3% of GDP in 2031, with an average real variation of -1.8% per year, due to the assumption of no salary increase for federal public servants. The rest of mandatory expenditures remains constant as a percentage of GDP at 5.1%, but there are relevant changes in its composition, mainly justified by the judicial claims and *Auxílio Brasil* expenses trajectory. Judicial claims (current and capital) expenses increase from 0.2% of GDP in 2021 to 0.4% of GDP in 2031, peaking in 2027, when they reach 0.6% of GDP, due to the payment of liabilities that will not be paid between 2022 and 2026 as a consequence of the limit imposed by the Constitutional Amendment 114. The *Auxílio Brasil* projections include the announced measures to expand the program, with a minimum BRL 600 benefit per family and an additional BRL 150 benefit per child up to 6 years, which increases this expenditure from 0.3% of GDP in 2021 to 1.2% of GDP in 2031.

As a result of the hypotheses assumed in this edition of the Report, the expenditure projections presented in the reference scenario are higher than those presented in the last edition, reaching an additional 0.6 percentage points of GDP in 2031, despite the recent revision of the GDP for 2020 and 2021 released by the Brazilian Institute of Geography and Statistics (IBGE), which reduced the expenditure projected in this report for all years by approximately 0.1 to 0.2 percentage points of GDP. In addition, alternative policy measures or events that translate into different assumptions than those adopted in this Report for mandatory expenses, such as salary readjustments for public servants, a real increase in the minimum wage, and the incorporation of more families in the *Auxílio Brasil* could increase the expenditure by around 1.6% of GDP by 2031. This reinforces the importance of offsetting mandatory expenses growth through a reduction of other expenditures, so that the discretionary expenses are not excessively compressed and that it is possible to comply with fiscal rules.

In the short run, the Regional Governments also contribute significantly to the Public Sector Primary Balance. The main driver for this was the good performance with state taxes on consumption, despite the effects of Complementary Law n. 194/2022, which established fuels, electricity, and telecommunications services as essential goods, thereby limiting the main state taxes (ICMS) on that goods and services. In the medium run, however, the Central Government dictates Public Sector's fiscal performance.

The reference scenario projections indicate that, at the end of 2022, the General Government Gross Debt (GGGD) and the General Government Net Debt (GGND) would be at 73.7% of GDP and 59.0% of GDP, respectively. The GGGD follows an upward trajectory until 2027, mostly due to primary deficits. The GGND, on the other hand, follows a more persistent growth trend, pressured by the differential between its implicit interest rate and the GDP growth rate for a longer time than GGGD, showing a downward trajectory only at the end of the projection period. In this scenario, the GGGD reaches 77.6% of GDP in 2031 and the GGND reaches 68.2% in the same year. In an alternative exercise, which incorporates the effects of the Constitutional Amendment Proposal nº 32 (Transition's PEC) approved in the Senate, the GGGD would reach 81.8% of GDP in 2026, 2.7 p.p. more than projected using the reference scenario.

GDP growth is a key variable for debt sustainability. The expected average GDP growth rate contributes to an average reduction of 1.7 percentage points per year in the GGGD to GDP ratio from 2023 to 2031. The GDP deflator, in turn, is also important, especially in the short term, because it has been systematically performing above inflation measured by the Broad Consumer Price Index (IPCA). Furthermore, the GDP revision for 2020 and 2021 represented a drop of 2 percentage points in the GGGD to GDP ratio. The GDP revision had a similar effect on GGND, however, this effect is more pronounced on GGGD due to a base effect.

As an alternative to the use of the official macroeconomic scenario, this report presents the evolution of the GGGD and the GGND using the median projections of the Focus survey published by the Brazilian Central Bank. In this more conservative scenario, debt shows an upward trajectory throughout the period, with the GGGD and the GGND reaching 90.4% and 78.8% of GDP in 2031, respectively.

This report also analyses the debt sensitivity to macroeconomic parameters, with comparative static exercises that illustrate how public debt projections change when key variables such as real GDP growth, the primary balance, and the interest rate deviate from the reference scenario along the entire horizon. A combination of shocks, for example of -0.5 p.p. in the primary balance, - 0.5 p.p. in GDP, and +1 p.p. at Selic, would result in an increase in gross debt of almost 20 p.p. at the end of 10 years when compared to the reference scenario.

In addition, we present stochastic simulations for GGGD and GGND in the face of correlated shocks to GDP and primary balances. This exercise highlights how GDP and primary balance dynamics generate uncertainties in the debt trajectory. The results show that an unfavorable sequence of macroeconomic shocks could lead the GGGD to 103.2% of GDP in 2031, and the GGND to 91.5% of GDP, 20 percentage points above the central scenario.

Therefore, the analyses and the simulations presented here show the need for a prudent fiscal strategy to promote public debt sustainability.