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Fiscal Outlook Report

Executive Summary

Table 1 summarizes the main results of the third edition of the Fiscal Outlook Report regarding the medium-term projections for the Brazilian fiscal scenario. Table 1The projections, made for a 10-year horizon, take into account the macroeconomic scenario prepared by the Secretariat of Economic Policy of the Ministry of Finance (SPE/MF), as of May 15, 2023, as well as the new rules under the Sustainable Fiscal Regime proposal. As described in Box 1, the new fiscal framework is based on the establishment of annual primary balance targets consistent with the sustainable trajectory of public debt, combined with annual limits on the primary expenditure growth, which depend on the achievement of the targets and revenue performance[1].

The macroeconomic scenario underlying this report shows stronger real GDP growth than the previous one, converging to an average of 2.5% per year. Combined with the robust tax revenue performance observed in 2022 and the first half of 2023, as well as the recently implemented measures to restore the tax base, a more favorable evolution of primary revenues is expected compared to the previous edition's projections. However, projection exercises explored in this Report indicate that meeting fiscal targets will still require new efforts on the revenue and expenditure sides as early as 2024. In line with this assessment, the Annex of Fiscal Targets that accompanied the Budget Guidelines Bill (PLDO 2024) indicated the need of new legislative measures to increase revenues in about BRL 155.7 billion (1.3% of GDP). These measures are still under discussion in the Executive Branch .

The reference fiscal scenario of this report assumes the implementation of additional revenue and expense containment measures to achieve the primary balance targets, without evaluating which options would be preferable. Thus, the central premise of the reference scenario of this report is the commitment to the fiscal sustainability and consolidation process as disclosed by the Ministry of Finance in several official statements and in the media. The Report addresses, in turn, the implications and inherent difficulties in the fiscal effort that will be necessary to sustain this scenario.

Table 1 – Summary of fiscal projections in the reference scenario (% of GDP)
Source: National Treasury Secretariat

Description	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public Sector Primary Balance	1.3	**-0.5**	**-0.1**	**0.4**	**0.9**	**-1.2**	**0.5**	**0.8**	**1.0**	**1.2**	**1.3**
Central government	0.6	**-0.8**	**0.0**	**0.5**	**1.0**	**-1.1**	**0.6**	**0.8**	**1.0**	**1.3**	**1.3**
Net Revenue	18.7	18.3	18.6	18.8	19.1	18.9	18.9	19.0	19.1	19.1	19.1
Total Expenditure	18.2	19.0	18.6	18.3	18.1	20.0	18.4	18.1	18.0	17.9	17.8
Regional Governments	0.7	**0.3**	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Federal State Enterprises	0.0	**-0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.0**
Interest Payments	5.9	**6.5**	**6.7**	**5.8**	**5.3**	**5.4**	**5.2**	**5.0**	**4.9**	**4.9**	**4.8**
Public Sector Overall Balance	-4.6	**-7.3**	**-6.8**	**-5.3**	**-4.4**	**-6.6**	**-4.7**	**-4.2**	**-3.9**	**-3.6**	**-3.5**
General Government Net Debt	57.4	**59.6**	**61.0**	**61.3**	**61.2**	**63.0**	**63.1**	**62.9**	**62.6**	**62.2**	**61.7**
General Government Gross Debt	72.9	**75.1**	**76.0**	**75.5**	**74.7**	**75.9**	**75.3**	**74.5**	**73.5**	**72.4**	**71.2**

[1] This report was produced based on the version of Complementary Bill No. 93/2023 approved by the Chamber of Deputies. The process in the Senate brought some changes in the proposal that were not incorporated in the scenarios of this report. For more information and analysis of the impact of the version approved in the Senate, see Box 1.

With the exception of 2022, which had a primary surplus of 0.6% of GDP, the Central Government has shown a sequence of primary deficits since 2014: almost a decade with an average primary deficit of 2.5% of GDP, or 1.4% if we exclude the year 2020, which was significantly affected by the Covid-19 pandemic. The year 2022 itself also benefited by cyclical movements in commodities, as explored by Box 2, and by other extraordinary revenues. The goal of achieving zero primary balance in 2024 and consecutive increases to 0.5% of GDP in 2025 and 1.0% in 2026, as presented in the PLDO 2024, represents a commitment to reverse this scenario.

It is estimated that the Central Government's net primary revenue will reach 18.3% of GDP in 2023, growing to 18.6% and 18.8% of GDP in 2024 and 2025, respectively, reaching a peak of 19.1% of GDP in 2026 and remaining relatively stable at this level until 2032. The macroeconomic scenario and legislative measures already implemented, such as the exclusion of ICMS from the calculation basis of PIS/PASEP and COFINS credits and the reversal of some 2022 exemptions, contribute to this performance, but a total of 1.4% of GDP of additional permanent gross revenue measures will be necessary to achieve the 2024 target. Another 0.1 p.p. of GDP and 0.3 p.p. of GDP will have to be added to these measures to meet the 2025 and 2026 targets, respectively.

On the other hand, the primary expenditure is based on the budget programming contained in the 2nd Bimonthly Evaluation Report on Primary Revenue and Expenditure (RARDP), and its evolution is projected based on the Sustainable Fiscal Regime[2] in the form approved by the Chamber of Deputies. That is, the real growth of the expenditure limit is equivalent to a proportion of the real adjusted net revenue growth, with the upper and lower limits of 2.5% and 0.6%, respectively. This proportion depends on the achievement of the primary balance targets set forth in the LDO. In addition to the expenditure limit, the reference scenario considers the adoption of expenditure cuts necessary to achieve the primary outcome targets.

In fact, primary expenditure starts from 18.2% of GDP in 2022 and reaches 17.8% of GDP in 2032, presenting a gradual decrease over the projection horizon, which is interrupted by a peak in 2027, when primary expenditure reaches 20.0% of GDP due to the liabilities in judicial claims accumulated between 2022 and 2026 whose payments were limited by Constitutional Ammendment 114.

The evolution of mandatory expenditure depends on the individual trajectory of its main components. The largest component is the expense with the General Social Security Regime - RGPS, which goes from 8.0% of GDP in 2022 to 7.9% of GDP in 2032, growing on average 3.4% p.a. in real terms over the projection horizon[3]. Personnel expenses, on the other hand, decrease more sharply: from 3.4% of GDP in 2022 to 2.5% of GDP in 2032, due to the assumption of granting adjustments based on inflation from 2026 onward. The rest of the mandatory expenditures go from 5.2% of GDP to 5.0% of GDP in the same period, but there are significant changes in the composition of these expenses, including an increase in the proportion of GDP spent on the Continuous Benefit (BPC), the Federal Government's complementation to the Fundeb and with Judicial Claims of Current and Capital Expenditures. On the other hand, there is a reduction in expenses with the Bolsa Família Program, considering the assumption of adjustment every two years based on the previous year's inflation.

Discretionary expenses, projected as the residual between the expenditure limit and mandatory expenses, increase from 1.5% of GDP in 2023 to 2.4% of GDP in 2032, but they are impacted in 2024, 2025 and 2026 by the budgetary cuts applied to expenditure to meet the central target of the primary balance in the reference scenario. This increase over the projection horizon is allowed by the average real growth of the expenditure limit being higher than the average real growth of mandatory expenditure, which depends directly on the dynamics of primary

[2] According to the values of Decree No. 11,538/2023, prepared from the projections of the 2nd Bimonthly RARDP.

[3] Despite this variation being higher than the variation of GDP, the stability in proportion to GDP stems from the difference between the GDP deflator and the IPCA.

revenues: for the same macroeconomic scenario, a real growth of adjusted net revenue (RLA), which serves as a reference for the definition of the expenditure limit of the new framework, lower than 3.3% p.a. could compress discretionary expenses.

Despite the increase in discretionary expenses, this slack does not translate into budgetary space for funding or the adoption of new policies. This is due to the evolution of "rigid discretionary expenses", so-called because they are discretionary expenses designed to meet the new health and education minimums, the investment floor established by the new fiscal framework, and mandatory parliamentary amendments. As part of these expenses is associated with the change in primary revenue, the actual growth of the expenses projected in the reference scenario of this report implies a real reduction in non-rigid discretionary expenses over the projection horizon. This compression occurs markedly in the years when cuts are assumed to meet the primary balance target, reflecting the fiscal effort required to achieve the targets established in the PLDO 2024.

As a result of the assumptions adopted for the reference scenario, successive primary surpluses are projected from 2025 onwards, with the exception of 2027, in view of the payment of judicial liabilities. At the end of the horizon, the primary balance reaches 1.3% of GDP.

Regarding the evolution of public debt, the projections in the reference scenario of this report indicate that GGGD and GGND will reach 75.1% and 59,6% of GDP, respectively, by the end of 2023. Despite growing in the first years of projection, GGGD begins a downward trajectory in 2025, after reaching a peak of 76.0% of GDP in 2024. This trend would be temporarily interrupted in 2027, and then resume a downward trajectory from 2028 until the end of the projection horizon, reaching 71.2% of GDP. Expectations of positive primary balances and a reduction in the interest to GDP ratio will be crucial to ensure the downward trajectory of GGGD to GDP in the medium term.

Among the factors affecting the variation of GGGD to GDP in the period from 2023 to 2032, it is noteworthy that, on average, there would be a primary surplus of 0.5 p.p. of GDP against interest payments equivalent to 5.6 p.p. of GDP per year. In addition, the projections consider a specific scenario for the conditioning factors of the monetary base, such as currency operations, deposits (compulsory or voluntary) and liquidity lines. In this scenario, these variables would contribute to a reduction of about 0.4 p.p. of GDP per year in repo operations and, therefore, in GGGD. Finally, GDP evolution contributes to reducing the debt-to-GDP ratio (via the denominator) by 5.0 p.p. per year, with 1.8 p.p. associated with real GDP and 3.2 p.p. related to the GDP deflator.

Looking specifically at the first year of the projections, the Central Government's primary result would need to reach a surplus of 1.1% of GDP for the GGGD to GDP in 2023 to stabilize at the same level as in 2022 (72.9% of GDP).

The Report also presents alternative scenarios, in which different assumptions for the primary balance are adopted. In particular, the reference scenario, mentioned in the previous paragraph, and the lower bound scenario (in which the primary balance is close to the lower limit of the primary targets until 2026) result in very similar debt trajectories. The baseline scenario is more conservative, especially regarding the trajectory of revenues, by not incorporating additional revenue measures (only keeping the ones currently in force), as well as allowing the expansion of expenditure without cuts. Thus, in this scenario the GGGD to GDP would grow for a longer period, reaching 82.1% of GDP in 2029 and assuming a slow process of reduction after that year, ending 2032 at 81.3% of GDP, against 71.2% of GDP in the reference scenario.

Additionally, in order to analyze the sensitivity of debt to macroeconomic parameters, comparative static exercises are carried out to illustrate how public debt projections change when key variables, such as real GDP growth, the primary result, and the interest rate deviate from the reference scenario over the entire horizon. A combination of shocks, such as a 0.5 p.p. decrease in the primary balance, a 0.5 p.p. decrease in GDP and a 1 p.p. increase in the Selic rate, for example, would result in a gross debt approximately 16 p.p. higher at the end of the 10-year period when compared to the reference scenario.

Furthermore, stochastic simulations for GGGD and GGND are presented, in the form of confidence intervals, in the face of correlated shocks in GDP and in the primary result. This exercise shows how the dynamics of GDP and the primary balance generate uncertainties in the debt trajectory. Based on a central scenario in which indebtedness is still high, this analysis highlights the importance of prudent fiscal management and the adoption of sound macroeconomic policies and measures to mitigate fiscal risks, including efforts to improve the fiscal balance, promote debt reduction and ensure long-term financial stability.