Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

AGO 17, 2022 • Nº 67

HIGHLIGHTS

- GDP should grow 2.0% in 2022, slowing down to 0.6% in 2023.
- Preliminary data indicate a central government's primary surplus of R$ 72.0 billion until July.
- The IFI's forecast for the central government's primary balance in 2022 is now a surplus of R$ 27.0 billion.
- Reserve liquidity has allowed the Treasury some slack in managing debt in 2022.
- IFI projection for General Government Gross Debt in 2022 became 78.8% of GDP.
- Nominal GDP and net redemptions of securities are the main factors reducing the DBGG as a proportion of GDP this year.
- Salary readjustment of 18% in the Judiciary would have an impact of R$ 1.8 billion (2023), R$ 5.5 billion (2024), and R$ 6.3 billion (2025 onwards).
- The Government sanctioned the LDO with partial vetoes. A provision that allowed the primary deficit target adjustment to the spending ceiling was vetoed.

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REPORT LAYOUT
COMAP/SECOM and SEFPRO/SEGRAF

Covering letter

The Fiscal Follow-up Report (RAF) is the IFI's monthly economic analysis and serves the purposes in art. 1 of Senate Resolution No. 42 of 2016. Periodically, usually in May and November, the RAF also presents a broad review of the fiscal scenario for ten years ahead. Starting in June of this year, we began updating the forecasts every month to capture the short-term dynamics of the economic variables in a timelier manner.

The first part of the RAF analyzes the macroeconomic context. Leading indicators for the second quarter continue to show positive activity performance, with the services sector playing a leading role. This more favorable dynamic, combined with the potential effects of the expansion of social transfers on household consumption, allows us to raise our projection for real GDP growth in 2022 from 1.4% to 2.0%. The perspective, however, is not maintained for 2023. The monetary tightening and the less dynamic global growth led to an adjustment in the projection for next year's growth from 0.7% to 0.6%.

The labor market follows a recovery path. The unemployment rate fell again in June and is now at 9.3%, well below the 14.2% registered in June 2021. It is the lowest level since the beginning of 2016. The participation rate - which measures entry and exit of the working-age population in the labor market - came in at 62.6%, better than a year ago but still below pre-pandemic levels. Our projection for average unemployment in 2022 dropped from 10.7% to 9.8%. The overall wages, affected by the high inflation, increased 4.8% compared to June 2021, without yet recovering the level of early 2020.

Inflation has its first relief after government measures. The July IPCA registered a deflation of 0.68% and now accumulates a high of 10.1% in twelve months. The exemption of fuel and electricity prices contributed to the change in administered prices from 0.48% to -4.35% between June and July. Free prices, meanwhile, continue under pressure, especially food-at-home (1.47% in the month and 17.49% over 12 months). We revised the IPCA estimate for 2022, from 7.4% to 7.2%, and for 2023, from 4.8% to 5.0%.

The second part of the RAF deals with the fiscal environment. This month we raise the projection again for central government revenues due to the results realized until July and the higher growth expected for the economy in 2022. Preliminary data show that the central government has accumulated a primary surplus of about R$ 72.0 billion through July. In this context, the IFI's forecast for the federal government's primary result is a surplus of R$ 27.0 billion in 2022, compared to a deficit of R$ 40.9 billion in the previous scenario. In turn, the general government's gross debt should end the year at 78.8% of GDP, below the 79.4% projected in the July report.

We also commented on the spending freeze to comply with the spending ceiling. At the end of July, the government released new fiscal estimates for 2022. Unlike the primary balance target, which is very comfortable given the tax collection performance, the spending ceiling remains under pressure. In the last evaluation, the government identified the need to block R$ 12.7 billion in discretionary spending by the Executive Branch, 8.2% of the total authorized in the budget. The most affected areas were Education and Health. The block also affected more than a third of the amendments of the budget's general rapporteur.

Finally, two highlights. The first is the vetoes to the PLDO. In particular, we are talking about the provision that allowed the primary balance to be adjusted according to the inflation rate used to correct the spending ceiling, which is generally different from the one foreseen in the LDO. For the President of the Republic, such a command would bring uncertainty about the primary balance commitment of the central government. The second highlight deals with the possibility of an 18% readjustment in the STF minister's allowance and the Judiciary's career remuneration. According to the IFI, the measure's impact would be R$ 1.8 billion in 2023, R$ 5.5 billion in 2024, and R$ 6.3 billion from 2025 onwards.

Daniel Veloso Couri
IFI Executive Director

Vilma da Conceição Pinto
IFI Director

Summary

- The expectation for GDP growth this year was adjusted from 1.4% to 2.0% with the incorporation of (i) the dynamics of economic activity data in the short term and (ii) the effect of the expansion of social transfers (EC No. 123/2022) on household consumption. The fiscal stimuli should promote a milder deceleration in economic activity during the second semester. The variation rate expected for 2023, on the other hand, was adjusted downwards, from 0.7% to 0.6%, affected by the impact of the monetary tightening underway carried out by the Central Bank and the less dynamic global growth. **(Page 6)**
- The IFI has again revised the projection for the total primary revenue of the central government in 2022. This change was motivated by the revision of the 2022 GDP estimate and the recent behavior of unmanaged revenues. In July, there was a significant collection of dividends from Petrobras of R$ 6.9 billion. In the year to July, non-managed revenues are already R$ 101.5 billion, higher than the amount collected in the same period of 2021. **(Page 12)**
- According to the Treasury, the public debt liquidity reserve has registered values higher than those initially planned for the year due to some atypicality in the collection of dividends from state-owned companies, a more elevated amount obtained with the untying of resources from public funds, and a value above the projection for the Central Bank's operating result. This allowed the Treasury to maintain its initial funding strategy in the context of increased uncertainty in the economic environment. **(Page 23)**
- Applying an 18% readjustment to the Judiciary Branch's 2021 compensation and payroll charges (R$ 34.8 billion), we obtain R$ 41.1 billion, an increase of R$ 6.3 billion. Since the planned readjustments would be staggered, initially, the expense would rise to R$ 36.6 billion in 2023 (R$ 1.8 billion more than in 2021). In 2024, it would increase to R$ 40.3 billion (R$ 5.5 billion more than in 2021). Finally, in 2025, it would rise to R$ 41.1 billion (+ R$ 6.3 billion). For the Public Prosecutor's Office, the figures would be: in 2023, total spending would rise to R$ 5.7 billion (+ R$ 284 million); in 2024, it would increase to R$ 6.3 billion (+ R$ 851 million); in 2025, it would rise to R$ 6.4 billion (+ R$ 972 million). **(Page 34)**

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1. MACROECONOMIC CONTEXT

1.1 Economic activity

High-frequency data indicates economic growth in the second quarter. After having advanced 1.0% in the first three months of 2022, compared to the previous quarter, seasonally adjusted, GDP should continue to expand in the second quarter, following the performance of the main productive sectors between April and June. Between the first and second quarters of 2022, industrial production and service sector revenues advanced, in that order, 0.9% and 1.1%, and retail sales fell 1.4%. The IFI's projected growth for the second quarter GDP is 0.8% compared to the immediately previous three months, seasonally adjusted.

The services sector plays an essential role in the evolution of economic activity in the short term, sustaining the growth trend in June. The services sector continues to play a leading role in the development of economic activity, benefiting from the reopening process, after the restrictions on mobility, at the end of 2021. In June, the volume of services rose 0.7% in comparison with May, seasonally adjusted, according to data from the IBGE's PMS (Monthly Services Survey). With the June result, considering the maintenance of the current level in July, August, and September, the carry-over of services for the third quarter is estimated at 1.1%.

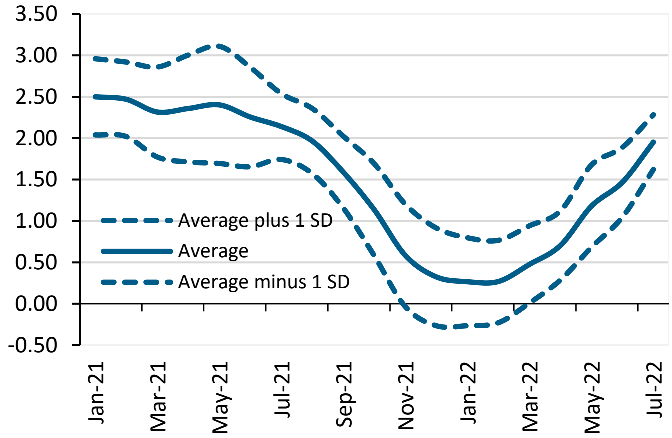
On the other hand, the industrial production and retail sales data show a loss of growth pace in June. The retail sales volume (PMC - Monthly Retail Trade Survey) decreased 2.3% between May and June in the expanded concept, which includes vehicles and construction materials. Considering the maintenance of the current level in July, August, and September, the retail carry-over for the third quarter is estimated at 1.1%.

According to the IBGE's PIM (Monthly Industrial Survey), general industry production shrank 0.4% from May to June (seasonally adjusted), interrupting a sequence of four consecutive monthly increases. In the previous month, the index had grown 0.3%. The June result, compared to the last month, reflected the mining industry's performance (up 1.9%), while the manufacturing industry shrank 0.3%. The performance among the manufacturing categories was mixed. While the capital goods (-1.5%), intermediate goods (-0.8%), and semi-durable and non-durable consumer goods (-0.7%) sectors shrank, the durable consumer goods production advanced significantly (6.4%).

It is worth pointing out that the industrial sector is still at a lower level than before the pandemic, limited by the persistence of bottlenecks in the global production chains. With the negative result for June, considering the maintenance of the current level of the general industry in July, August, and September, the carry-over for the third quarter is estimated at -0.2%.

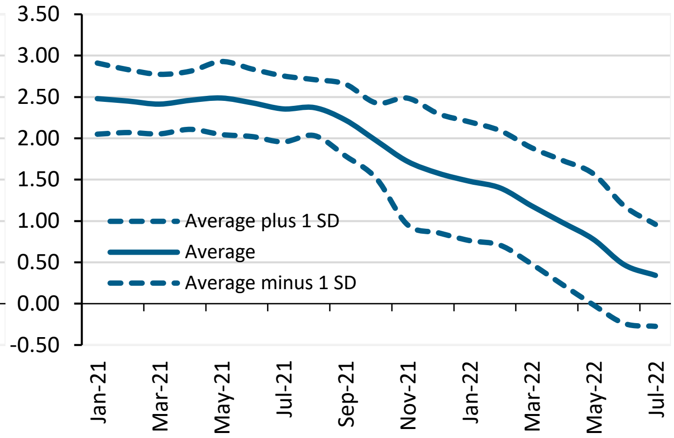
Market estimates in the Focus survey indicate continued GDP improvement in 2022, but the expected slowdown for 2023 GDP is substantial. The economic activity resilience and the effects of stimulus measures on consumption explain, to some degree, the increase in the average of the projections for growth in 2022, currently at 2.0% (one standard deviation range between 1.6% and 2.3%). By 2023, the movement is the opposite. The average of the estimates reached 0.3% in July (with a standard deviation between -0.3% and 1.0%), reflecting the impact of monetary tightening on aggregate demand and the perspective of decelerating global growth. Figures 1 and 2 show the 2022 and 2023 GDP estimates obtained from the Central Bank's Focus survey between January 2021 and July 2022.

FIGURE 1. MARKET FORECASTS - GDP (2022)



Source: Central Bank. Prepared by: IFI.

FIGURE 2. MARKET FORECASTS - GDP (2023)



Source: Central Bank. Prepared by: IFI.

GDP is expected to grow 2.0% in 2022, slowing down to 0.6% in 2023. IFI's expectation for GDP growth for this year was adjusted from 1.4% to 2.0% with the incorporation of (i) the positive dynamics of economic activity data in the short term and (ii) the effect of the expansion of social transfers (EC No. 123/2022) on household consumption. The fiscal stimuli should promote a milder deceleration in economic activity during the second semester.

On the other hand, the variation rate expected for 2023 was adjusted downwards, from 0.7% to 0.6%. The impact of the monetary tightening on aggregate demand and the less dynamic global growth should harm the performance of the economy in the coming quarters. Faced with the advance of inflation – influenced by the disarray in global production chains and by the rise in commodity prices, intensified by the war – central banks are withdrawing the monetary stimulus adopted during the fight against the pandemic. The contractionary stance of monetary policy has affected the outlook for economic growth in the major economies, as signaled by the IMF in its July *World Economic Outlook Report*.

1.2 Labor market

Labor market indicators continue to recover in the second quarter. The data released by the IBGE in the Continuous National Household Sample Survey (PNAD Continuous) show a significant increase in the employed population, both in the informal and formal sectors, and a decrease in the unemployment rate and discouragement. Despite the drop in salaries in real terms, affected by high inflation, the increase in hiring influences the overall earnings – a relevant variable to explain household consumption dynamics.

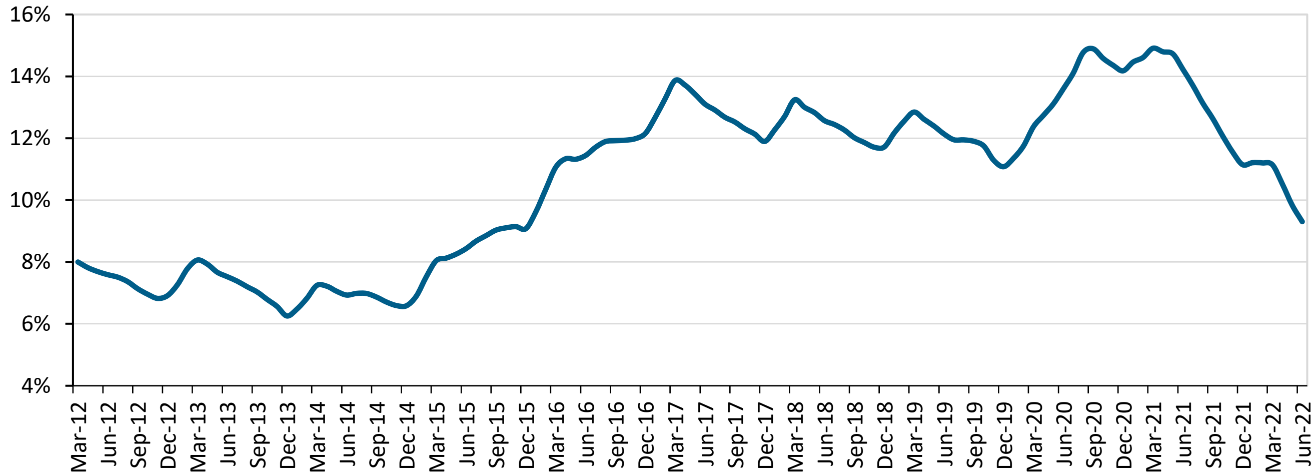
TABLE 1. LABOR MARKET INDICATORS

	Values (million)			Quarter x last quarter		
	Jun-20	Jun-21	Jun-22	Jun-20	Jun-21	Jun-22
A – Working-age population	169.9	171.5	173.1	1.0%	1.0%	0.9%
A.1 – People outside the labor force	72.6	67.3	64.7	19.1%	-7.3%	-3.8%
A.2 – Labor force population	97.3	104.2	108.3	-9.2%	7.1%	4.0%
A.2.1 – Unemployment	13.2	14.8	10.1	1.7%	12.1%	-32.0%
A.2.2 – Employment	84.1	89.4	98.3	-10.7%	6.3%	9.9%
Informal employment	30.7	35.8	39.3	-20.1%	16.5%	9.9%
Formal employment	53.4	53.6	59.0	-4.3%	0.5%	10.0%
Unemployment rate (A.2.1/A.2)	13.6%	14.2%	9.3%	1,5 p.p.	0,6 p.p.	-4,9 p.p.
Employment rate (A.2.2/A)	49.5%	52.1%	56.8%	-6,5 p.p.	2,6 p.p.	4,7 p.p.
Participation rate (A.2/A)	57.3%	60.8%	62.6%	-6,5 p.p.	3,5 p.p.	1,8 p.p.

Source: IBGE. Prepared by IFI.

The unemployment rate drops to 9.3% in the second quarter, maintaining the downward trend that began in mid-2021. The unemployment rate reached 9.3% of the labor force in the quarter ended in June (Table 1 and Figure 3), 4.9 percentage points (p.p.) below the rate recorded in the same period a year earlier (14.2%). The reduction in the unemployment rate is the result of the increase in the pace of hiring, which brought the number of employed people to 98.3 million (an expansion of 9.9% compared with the same period in 2021), exceeding the growth in the labor force (up 4.0% in the same comparison), comprised of people who are employed or seeking employment (unemployed population).

FIGURE 3. UNEMPLOYMENT RATE (% TOTAL LABOR FORCE)

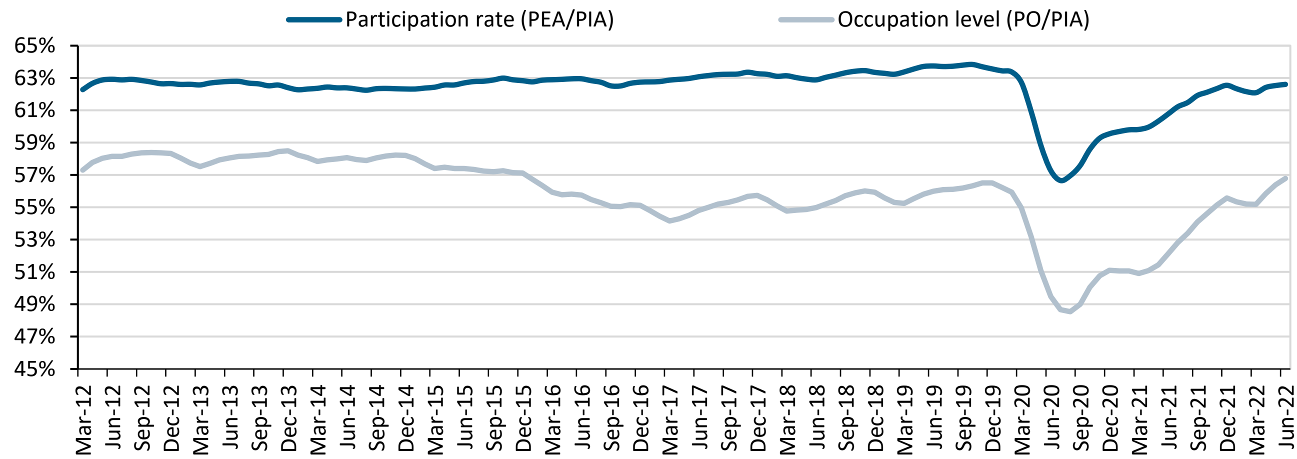


Source: IBGE. Prepared by: IFI.

Demand for labor: the increase in employment occurs in both the formal and informal markets. The population employed in the informal segments of the economy (39.3 million people) grew 9.9% compared to the same period last year. At the same time, formal employment (59 million) rose 10%. The expansion in hiring impacts the occupation level (the ratio between the employed and working-age populations). In June, the indicator rose to 56.8%, 4.7 p.p. above that recorded in the same period in 2021 and 0.9 p.p. above February 2020 (before the pandemic).

Labor supply: participation rate advances but remains below the pre-pandemic period. The growth in the labor force drives the participation rate, a measure that tracks the entry and exit of the working-age population from the labor market. The indicator, expressed as the ratio between the number of people in the labor force and the working-age population, reached 62.6% in the quarter ended in June, as shown in Figure 4 (1.8 p.p. above the level in the same period a year earlier). The participation rate is evolving positively, indicating the return of people to the labor market, but it remains at a lower level in the months before the pandemic (63.4%).

FIGURE 4. PARTICIPATION RATE AND OCCUPATION LEVEL



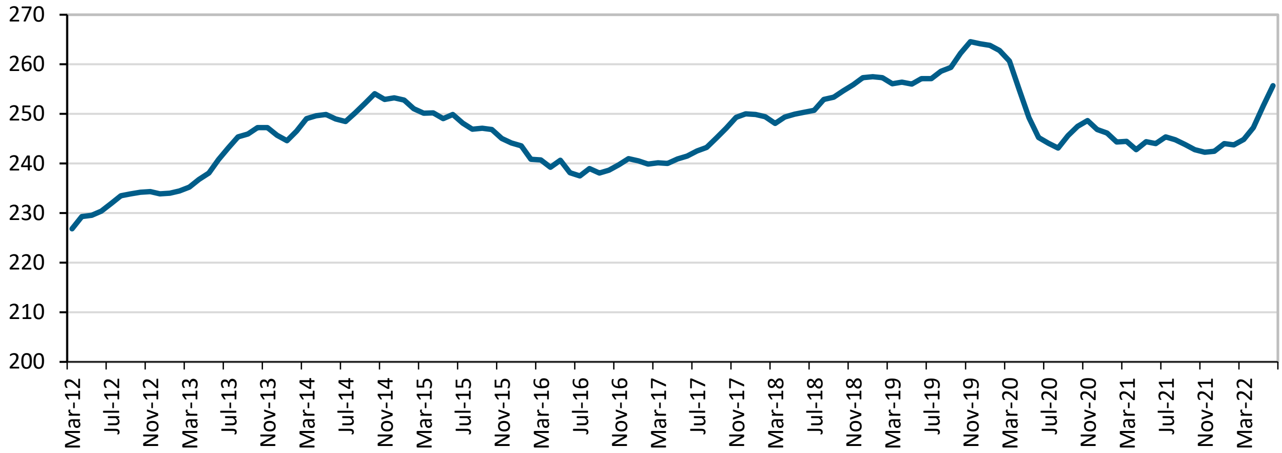
Source: IBGE. Prepared by: IFI.

The decrease in discouragement reinforces the picture of better conditions in the labor market. In the quarter that ended in June, the contingent of discouraged people – individuals who do not look for work but would like to and were available for it – reached 4.3 million people, which represents a drop of 22.5% to the same period in 2021 (5.5 million), confirming the scenario of recovery in labor market conditions.

We reduced the average unemployment rate estimate from 10.7% to 9.8% in 2022. Even with the increase in the labor force and the participation rate – reflecting the return of previously inactive people to the labor market, possibly due to the pandemic slowdown and the recovery in activity – the IFI's projection for the 2022 average unemployment rate was adjusted from 10.7% to 9.8%, due to the intense pace of expansion in hiring.

Improvement in job creation contributes to the expansion of the overall earnings. Also, according to data from PNAD Continuous, the average real income in the quarter ended in June dropped 5.1% compared to the same period last year, negatively impacted by high inflation. The overall earnings, on the other hand, an indicator that combines the evolution of income and the occupied population, advanced 4.8% in real terms in the same comparison. Figure 5 shows its recovery trajectory, although it remains below the pre-pandemic level.

FIGURE 5. OVERALL LABOR EARNINGS
R$ BILLION (AT APRIL-JUNE 2022 PRICES)

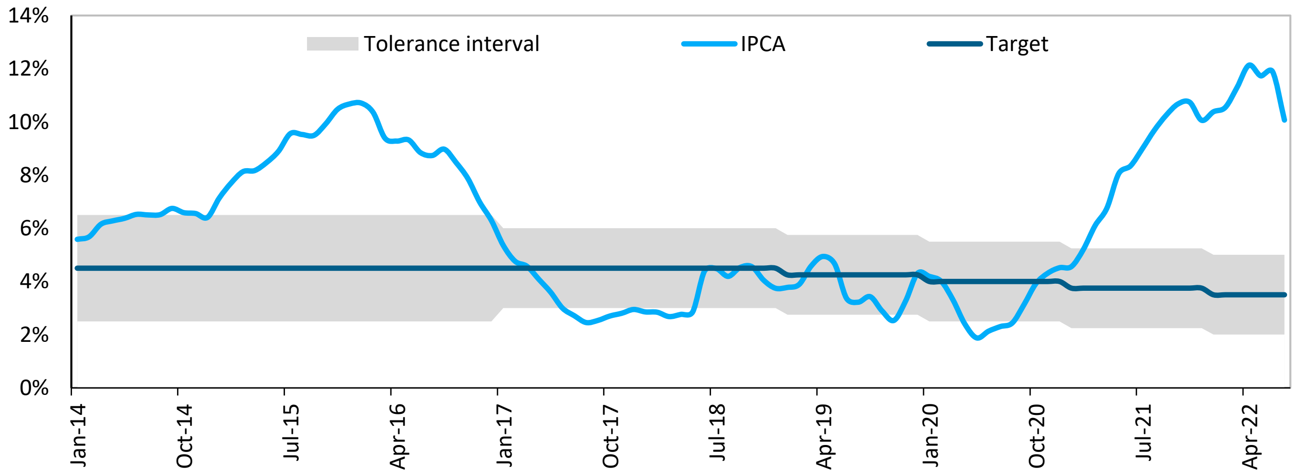


Source: IBGE. Prepared by: IFI.

1.3 Inflation and monetary policy

IPCA shows deflation in July. The July IPCA registered a variation of -0.68%, 1.35 p.p. below the rate recorded in June (0.67%). In the 12 months ended in July, the rise in the IPCA slowed down to 10.1% (Figure 6), below the 11.89% registered in the immediately preceding 12 months (i.e., ending in June). Consumer inflation has been above 10% since September 2021 and exceeds the upper limit of the target defined by the National Monetary Council (CMN) for 2022 (reference of 3.5% with an interval of 1.5 p.p. above and below). The IFI's inflation projections are 7.2% for 2022 and 5.0% for 2023, marginally adjusted from 7.4% and 4.8%, respectively.

FIGURE 6. IPCA, INFLATION TARGET AND TOLERANCE INTERVAL (% 12 MONTHS)



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

Average cores are still under pressure. The diffusion index, which measures the proportion of goods and services that had price increases in the period to the total items surveyed, decreased from 66.6% to 62.9%. The average of the cores monitored by the Central Bank – measures that seek to remove the influence of more volatile items from total inflation – slowed down marginally, from 10.5% to 10.4%, in the 12-month accumulated, after several consecutive months of highs, although it still shows a picture of persistent inflation.

TABLE 2. IPCA: MONTH % CHANGE AND 12-MONTH

Consumer inflation	Month % change			12-month		
	May-22	Jun-22	Jul-22	May-22	Jun-22	Jul-22
IPCA	**0.47%**	**0.67%**	**-0.68%**	**11.73%**	**11.89%**	**10.07%**
Administered prices	**-0.51%**	**0.48%**	**-4.35%**	**12.09%**	**11.73%**	**5.10%**
Market prices	**0.83%**	**0.74%**	**0.65%**	**11.60%**	**11.94%**	**11.89%**
Food-at-home	0.43%	0.63%	1.47%	16.35%	16.69%	17.49%
Services	0.85%	0.90%	0.80%	8.00%	8.73%	8.87%
Industrial goods	1.06%	0.58%	-0.11%	13.97%	13.73%	12.83%
Average of inflation cores	**0.93%**	**0.89%**	**0.53%**	**10.11%**	**10.50%**	**10.43%**

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

The reversal of administered prices explains a good part of the deflation registered by the July IPCA. Between June and July, the change in administered prices (or monitored prices), which account for approximately 25% of the total IPCA, went from 0.48% to -4.35% (Table 2), impacted by tax exemption on fuel and electricity prices. Free prices, meanwhile, rose 0.65%, slowing down compared to June (0.74%). In 12 months, the variation in these prices rose from 11.94% to 11.89%. The openness of free prices shows that the most significant pressure in July came from food-at-home (1.47% in the month and 17.49% in 12 months).

The Selic is expected to close the year at 13.75%, remaining at a high level through 2023. In July, the Monetary Policy Committee (Copom) decided to raise the base interest rate by 0.5 p.p. to 13.75%. The communication released after the meeting (statement and minutes) signaled that the committee would assess the need for a residual adjustment, of a smaller magnitude, at the next meeting (September 21).

In discussing the scenario update that justified the decision, Copom mentioned (i) the adverse and volatile external environment, marked by negative revisions for global growth in an inflationary environment still under pressure; (ii) the performance of domestic economic activity indicators pointing to GDP growth in the first half of the year, with a more potent than expected recovery in the labor market; and (iii) consumer inflation, as measured by the IPCA, more persistent than anticipated. In the reference scenario, Copom's inflation projections are 6.8% for 2022 and 4.6% for 2023, already incorporating the effects of recently approved tax measures.

Copom emphasized that risk factors remain in both directions in its inflation scenario. Among the upside factors, the committee mentions the more remarkable persistence of global inflationary pressures, the uncertainty about the future of the country's fiscal framework, and additional budgetary stimuli that imply sustaining aggregate demand, partially incorporated in inflation expectations and asset prices. Among the downside risks, we highlight a possible reversal of the increase in commodity prices in local currency and a sharper-than-projected slowdown in economic activity.

We have maintained, for now, the Selic projection for the end of the year at 13.75%. The perspective of a still challenging inflationary scenario and the displacement of inflationary pressures for next year resulting from the tax measures should affect the space for reduction currently foreseen. Our scenario contemplates the Selic rate at the end of 2023, reaching 10.50% (revised from 10.25%).

2. FISCAL SCENARIO

2.1 Primary revenues and transfers

Tax collections maintained substantial expansion in July. According to information gathered by the IFI in the portal Siga Brasil, from the Federal Senate, and in the Report Central Government Primary Balance (RTN), from the National Treasury Secretariat (STN), the central government's total primary revenue, which includes the federal government, the Central Bank and the INSS, grew 8.4% above inflation compared to the same month last year. Managed revenues increased by 4.7%, while the net collection for the RGPS was 2.7% and the unmanaged revenues 31.4%.

In 2022, revenues continue to grow significantly compared to 2021. In the first seven months of 2022, total revenue reached R$ 1,365.8 billion, an increase of 15.1% compared to 2021, discounting the effects of inflation (Table 3). The collection in 2022 has surprised positively and continues to reflect (a) the domestic economic activity, especially in the service sector, after the pandemic has cooled down and vaccination has advanced, (b) inflation, which increases the tax bases, and (c) commodity prices. Among the main groups that make up the revenues, the revenues collected by the Federal Revenue Office (managed revenues) advanced 10.0% in real terms. The net collection for the RGPS rose 7.2% in real terms, while the revenues not collected by the Federal Revenue Office (unmanaged revenues) grew 51.7% (Table 3).

TABLE 3. CENTRAL GOVERNMENT'S REVENUES – 2020 – 2022 – JAN – JUL (R$ BILLION CURRENT, REAL % CHANGE, AND % OF GDP)

	Jan-Jul/20			Jan-Jul/21			Jan-Jul/22		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total revenue	**769.7**	**-17.1%**	**18.3%**	**1,067.7**	**29.9%**	**21.6%**	**1,365.8**	**15.1%**	**24.6%**
Revenues Collected by RFB, except RGPS	*485.7*	*-16.4%*	*11.6%*	*677.7*	*30.8%*	*13.7%*	*827.8*	*10.0%*	*14.9%*
Fiscal incentives	*-0.1*	*-*	*0.0%*	*-0.1*	*-*	*0.0%*	*-0.1*	*-*	*0.0%*
RGPS	*193.2*	*-17.3%*	*4.6%*	*242.9*	*17.7%*	*4.9%*	*289.3*	*7.2%*	*5.2%*
Revenues not collected by RFB	*91.1*	*-20.0%*	*2.2%*	*147.2*	*51.1%*	*3.0%*	*248.7*	*51.7%*	*4.5%*
Transfers	**152.4**	**-9.0%**	**3.6%**	**196.4**	**20.6%**	**4.0%**	**264.7**	**21.3%**	**4.8%**
Net revenue	**617.4**	**-18.9%**	**14.7%**	**871.4**	**32.2%**	**17.6%**	**1,101.1**	**13.7%**	**19.8%**
Total revenue without non-recurrent event*	**853.7**	**-5.6%**	**20.3%**	**1,037.2**	**13.8%**	**21.0%**	**1,296.1**	**12.4%**	**23.3%**
Net revenue without non-recurrent event *	**769.7**	**-17.1%**	**18.3%**	**1,067.7**	**29.9%**	**21.6%**	**1,365.8**	**15.1%**	**24.6%**
GDP (R$ billion)			**4,198.5**			**4,949.4**			**5,551.8**

Source: STN, Central Bank, and Siga Brasil. Prepared by: IFI.
** The non-recurrent events are presented and described in the IFI's EE No. 17, 2021.*

Some taxes explain the expansion of managed revenues. In July, as in previous months, the taxes that showed the most remarkable increase in the group of collected revenues were Income Tax (IR), the Social Contribution on Net Corporate Profits (CSLL), and the Tax on Credit Operations, Exchange, and Insurance (IOF).

Social security revenues have grown in the wake of the labor market's recovery. Unemployment is falling, and the overall wages have shown expansion sustained by the recovery in employment, even though average real income is declining due to high inflation in the economy.

In unmanaged revenues, concessions, dividends, and oil boost collections. The unmanaged revenues exhibit the highest expansion rate among the three main groups that comprise the Federal Government's primary revenues. This collection jumped from R$ 147.2 billion in the first seven months of 2021 to R$ 248.7 billion this year. Three collections stand out in this group of revenues: (i) concessions and permissions, which went from R$ 2.3 billion in the January-July 2021 period to R$ 41.7 billion in the same period of 2022 due to R $11.6 billion received in February as a signature bonus from the second round of bidding for surplus volumes from the onerous transfer and R$ 26.6 billion received in June referring to the granting of new power generation concession contracts arising from the privatization of Eletrobras; (ii) dividends, whose collection jumped from R$ 16.1 billion to R$ 51.8 billion, concentrated in transfers from BNDES and Petrobras; and (iii) revenues from the exploitation of natural resources, which reached R$ 86.0 billion in the year to July 2022, against R$ 62.7 billion in 2021.

The increase in income tax collection, oil exploration, and Law No. 14337 explains the increase in transfers to subnational entities. Also, according to Table 3, the transfers by revenue sharing totaled R$ 264.7 billion until July, a rise of 21.3% over 2021 (real terms). This increase in transfers reflects the rise in the Income Tax collection and collections from oil exploration, as well as Law No. 14337 of May 11, 2022, which provides for an additional transfer to the subnational entities of R$ 7.7 billion in 2022, by way of special credit, opened with funds from the excess of collection from concessions and permissions.

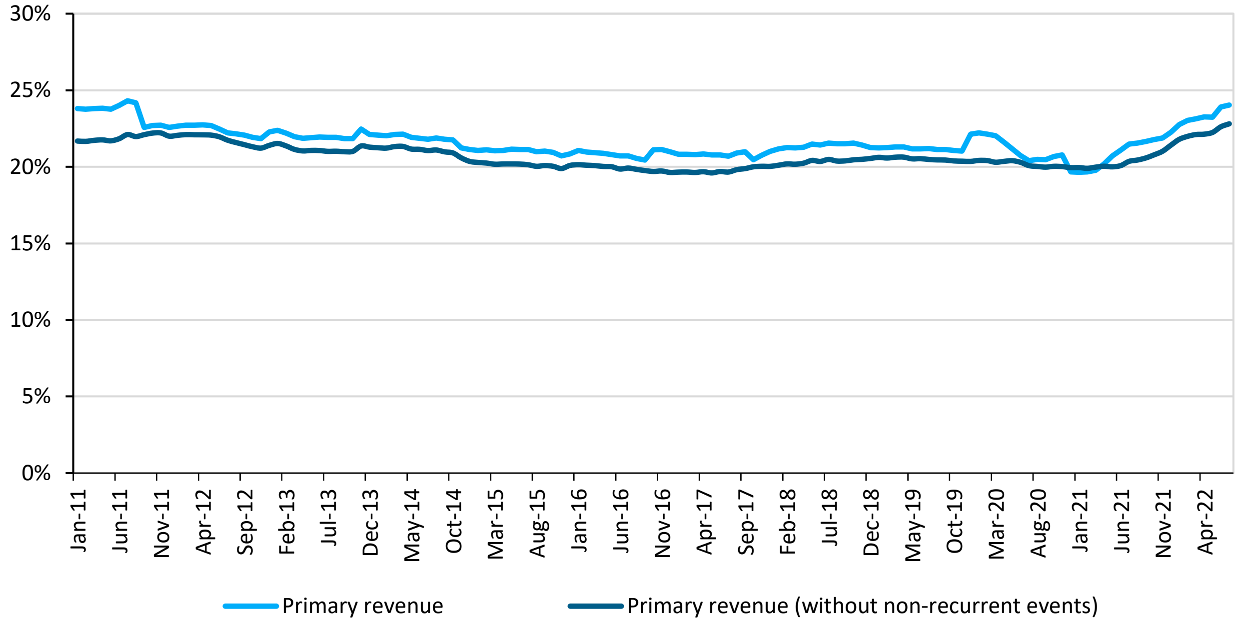
After discounting transfers by revenue sharing from total primary revenue, the net revenue of the central government totaled R$ 1,101.1 billion in 2022 through July, 13.7% higher in real terms than in the same period of 2021 (Table 3).

Total and net recurrent primary revenues of the Federal Government also show vigorous expansion in the year. Excluding non-recurring effects on revenues (payments of Refis, concessions and grants, anticipated dividends, operations with assets, and atypical collections reported by the Federal Revenue Office), the Federal Government's recurrent primary revenue was R$ 1,296.1 billion in the period from January to July, an increase of 12.4% compared to 2021 in real terms. The recurring net revenue, in turn, totaled R$ 1,031.5 billion in 2022 through July, an amount 10.4% higher, in real terms, than in the same period in 2021. The calculation of recurring revenues is based on the Special Study (EE) No. 17 of December 2021[2].

Figure 7 shows the evolution, since 2011, of total and recurring primary revenues as a proportion of GDP. In July 2022, the conventional primary revenue reached 24.0% of GDP, an increase of 2.5 p.p. compared to the same month in 2021, while the recurring revenue reached 22.8% of GDP, up 2.4 p.p. in comparison with July last year.

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

FIGURE 7. PRIMARY REVENUE (WITH AND WITHOUT NON-RECURRING EVENTS) - % GDP

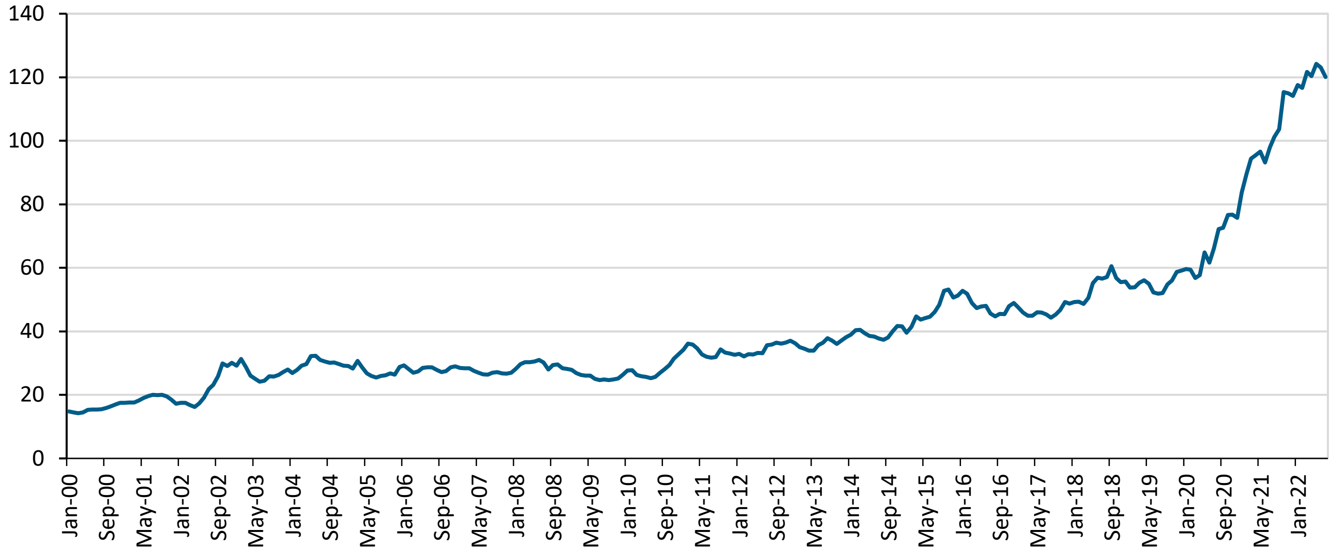


Source: STN. Prepared by IFI.

The isolation of non-recurring events on primary revenues shows the robustness of the results of federal tax collection in 2022, repeating what was observed last year. As highlighted in previous editions of this report, commodity prices, inflation, and the behavior of economic activity sustain this revenue performance. It is important to note, however, that the monetary tightening conducted by the Central Bank to reduce inflation and bring the IPCA to the target's center will affect economic activity, which should impact the evolution of tax collection.

To illustrate the dynamics of commodity prices, Figure 8 shows the evolution of the Brazil Commodities Index (IC-Br), calculated by the Central Bank. The indicator captures the prices of agricultural commodities, metals, and energy in reais, which are relevant to the dynamics of Brazilian inflation. The IC-Br had shown substantial growth since the second half of 2020, when it expanded by 21.5% compared to 2019. In 2021, the indicator advanced by 50.0%, and in the year to July 2022, it shows an increase of 29.6% over 2021.

FIGURE 8. COMMODITIES INDEX- IC-BR (AVERAGE 2021 = 100)



Source: Central Bank. Prepared by: IFI.

A possible drop in commodity prices represents a risk to the evolution of government revenues. The monetary authorities of the leading developed countries have started to adopt restrictive monetary policies due to high inflation. This coordinated tightening of monetary policy will weaken economies, potentiating the effects on emerging markets such as Brazil. One of the channels of this transmission would be commodity prices, for which some reduction is expected in the coming months. It is, therefore, one more risk factor for the tax collection scenario in Brazil, which the IFI is monitoring.

In the 12-month accumulated until July, revenues also showed substantial expansion. In the 12-month comparison, still according to the Treasury and Siga Brasil, total revenues reached R$ 2,230.7 billion (24.0% of GDP) in July 2022, an increase of 13.9% over July 2021 in real terms (R$ 1,766.1 billion, or 21.5% of GDP). On this basis of comparison, managed revenues grew 11.3% (R$ 1,345.8 billion), the net collection for the RGPS advanced 0.9% (R$ 508.7 billion), and unmanaged revenues rose 54.0% (R$ 376.4 billion).

The IFI's projection for total primary revenue in 2022 rose due to improved expectations for GDP. Our estimate was updated to R$ 2,319.9 billion (23.8% of GDP) against the previous forecast of R$ 2,222.9 billion (22.9% of GDP). The R$ 97.0 billion change was motivated by two reasons. The first was the change in the 2022 nominal GDP growth estimate from 11.8% to 12.3%, which resulted from the revision of expectations for real growth in the year, from 1.4% to 2.0%. The increase in the projection for nominal GDP increased the forecast for managed revenues (from R$ 1,343.5 billion to R$ 1,429.3 billion) and the net collection for the RGPS (from R$ 533.6 billion to R$ 540.8 billion).

The behavior of unmanaged revenues also led to an upward revision in the projection for total revenues for the year. The second factor in motivating the total revenue revision in 2022 was the behavior of unmanaged revenues. In July, there was a collection of R$ 6.9 billion from the distribution of dividends by Petrobras, which raised the IFI's projection for unmanaged revenues in 2022 by about R$ 4.0 billion (from R$ 345.8 billion to R$ 349.8 billion).

By comparison, in August, the median of the projections of the economists participating in the Monthly Report from Prisma Fiscal[3] of the Ministry of Economy was a federal collection of R$ 2,208.6 billion in 2022. In the same report, the average of the projections of the podium (most accurate economists) is R$ 2,251.5 billion. On the other hand, the Executive Branch prediction contained in the Assessment Report of Primary Revenues and Expenditures of the 3rd Bimester of 2022 July is total primary revenue of R$ 2,226.1 billion this year.

IFI's projection for the central government's net revenues in 2022 rose to R$ 70.4 billion. For net revenue, the IFI's projection increased from R$ 1,784.3 billion (18.4% of GDP) to R$ 1,854.7 billion (19.0% of GDP). The increase in the net revenue estimate was lower than that of total revenue due to the increase in the projection for transfers by revenue sharing (from R$ 438.6 billion to R$ 469.5 billion). The market consensus captured by Prisma Fiscal in August contains a projection of R$ 1,817.8 billion for net central government revenue this year, while the average of the podium projections in the same Report is R$ 1,825.8 billion. According to the latest Bimonthly Report of Revenue and Expenditure Evaluation, the Executive Branch's projection for net revenue in 2022 is R$ 1,774.4 billion.

It is worth mentioning that the IFI's projections for the total and net primary revenues of the central government contemplate, besides the measures adopted by the government and presented in the RAF No. 64 of May 2022 (reduction of the PIS/Cofins on diesel oil and LGP, “Refis do Simples”[4], an increase of the CSLL for banks, reduction of the IPI and Import Tax rates), the drop to zero of the Cide and PIS/Cofins rates on gasoline and ethanol in June 2022. The projections do not consider possible anticipations of dividends from state-owned companies.

2.2 Primary expenditures

Primary expenditure continued to fall compared to the previous year. According to information from Siga Brasil, the central government's total primary expenditure was R$ 143.8 billion in July 2022, R$ 14.9 billion less than in the same month of 2021, a reduction of 17.7%. In July 2022, total spending was R$ 1,029.2 billion, a decrease of 1.9% (real terms) to 2021 (Table 4).

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[3] Available at: https://www.gov.br/fazenda/pt-br/centrais-de-conteudos/publicacoes/relatorios-do-prisma-fiscal/relatorio-mensal/2022/relatorio-mensal-2022_08-v4.pdf/view.

[4] Refis - Fiscal recovery program.

TABLE 4. SELECTED CENTRAL GOVERNMENT'S EXPENDITURES (R$ B CURRENT, REAL % CHANGE, AND % OF GDP)

Discriminação	Jan-Jul/20			Jan-Jul/21			Jan-Jul/22		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total expenditure	**1,122.6**	**41.0%**	**26.7%**	**944.5**	**-21.4%**	**19.1%**	**1,029.2**	**-1.9%**	**18.5%**
Social Security Benefits (RGPS)	*408.5*	*17.5%*	*9.7%*	*437.5*	*0.0%*	*8.8%*	*477.2*	*-1.8%*	*8.6%*
Personnel (working and retired employees)	*184.4*	*-0.4%*	*4.4%*	*190.4*	*-3.4%*	*3.8%*	*186.8*	*-11.6%*	*3.4%*
Salary allowance and unemployment insurance	*39.1*	*15.8%*	*0.9%*	*31.5*	*-24.1%*	*0.6%*	*46.9*	*33.8%*	*0.8%*
Continuous Cash Benefit (BPC)	*36.6*	*2.8%*	*0.9%*	*39.5*	*0.9%*	*0.8%*	*45.2*	*2.9%*	*0.8%*
Extraordinary Credits (except PAC)	*228.9*	*8,001.8%*	*5.5%*	*68.0*	*-72.5%*	*1.4%*	*14.9*	*-79.9%*	*0.3%*
Compensation to RGPS for Exemption of Payroll Taxes	*6.1*	*-12.6%*	*0.1%*	*4.7*	*-27.8%*	*0.1%*	*3.1*	*-40.7%*	*0.1%*
Fundeb	*10.2*	*0.7%*	*0.2%*	*11.4*	*5.0%*	*0.2%*	*19.1*	*49.9%*	*0.3%*
Court Rulings and Court-Ordered Debts	*21.5*	*46.3%*	*0.5%*	*17.5*	*-25.0%*	*0.4%*	*9.3*	*-52.3%*	*0.2%*
Subsidies, Grants, and Proagro	*10.6*	*4.2%*	*0.3%*	*5.2*	*-54.1%*	*0.1%*	*12.8*	*120.3%*	*0.2%*
Mandatory expenditure	**1,066.6**	**44.1%**	**25.4%**	**895.7**	**-21.6%**	**18.1%**	**954.8**	**-4.0%**	**17.2%**
Mandatory spending with flow control	***71.6***	***-10.3%***	***1.7%***	***79.4***	***3.8%***	***1.6%***	***125.4***	***42.1%***	***2.3%***
Discretionary	**56.0**	**-0.3%**	**1.3%**	**48.8**	**-18.8%**	**1.0%**	**74.4**	**36.9%**	**1.3%**
Total expenditure without non-recurrent events*	**797.0**	**0.1%**	**19.0%**	**825.6**	**-3.1%**	**16.7%**	**955.2**	**4.1%**	**17.2%**
GDP (R$ billion)			**4,198.5**			**4,949.4**			**5,551.8**

The non-recurrent events are presented and described in the IFI's EE No. 17, 2021.
Source: STN and Central Bank. Prepared by: IFI.

In the year-to-date, the expense with social security benefits under the RGPS fell 1.8%. It is worth mentioning that this reduction is not influenced by the anticipation of the payment of the annual bonus (Christmas bonus) to retirees and pensioners of the INSS since the accumulated seven months in 2021 and 2022 already contemplates this measure. In 2021, this payment anticipation was made in May, June, and July, while in 2022, it concentrated in April, May, and June. According to the STN, from January to June 2021, R$ 18.1 billion were paid as court-ordered payments of government debt, while in the same period in 2022, this payment totaled R$ 8.2 billion.

The salary allowance calendar change explains this expense's growth in 2022. In the year to July 2022, the highlights are the expenses with salary allowance and unemployment benefit - an increase of 33.8% to 2021. A comparison base effect explains this increase. In 2021, the costs with the salary allowance were low due to a change in the payments schedule, as per Resolution CODEFAT No. 896[5], of March 23, 2021. Until the publication of the mentioned Resolution, the salary allowance payments were made in twelve months starting in July of the following year. For example, the amounts referring to the calendar year 2019 were paid between July 2020 and June 2021. Resolution No. 896 changed the payment schedule from July/June to January/December. The calendar year 2020 amounts did not start being paid in the second half of 2021 but in the first half of 2022. This new schedule will be valid for all calendar years beginning in 2020.

Auxílio Brasil (Brazil Aid) payments and expenditures in the Health function drove the growth in mandatory spending with flow control and discretionary expenditures, respectively. From January to July, the mandatory expenses with flow control grew 42.1%, in real terms, compared to 2021. This increase is explained by the Brazil Aid

[5] Available at: https://portalfat.mte.gov.br/codefat/resolucoes-2/resolucoes-por-ano/2021-2/.

program, whose average benefit is much higher than its predecessor Bolsa Família (Family Allowance). On the other hand, the discretionary expenses of the Executive presented an increase of 36.9%, driven by the expenditures in the Health function (Table 4).

Table 4 also presents the recurrent expenses of the central government, calculated by the IFI based on the methodology published in EE No.17, December 2021. The calculation considers as non-recurring expenses the expenses of Covid-19, the onerous assignment of the pre-salt, the Brazilian Sovereign Fund, and anticipations in the payment of the salary allowance and the RGPS 13th salary bonus.

Expenses aimed at fighting the pandemic and anticipation of the 13th INSS bonus explain the difference between conventional and recurrent primary expenses. In the accumulated until July 2022, the recurrent primary expenditure (without non-recurring events) presented an increase of 4.1% over 2021. The difference is explained by: (i) R$ 17.4 billion of expenses executed in the scope of the pandemic; and (ii) R$ 56.6 billion paid in anticipation of the 13th bonus to retirees and pensioners of the INSS.

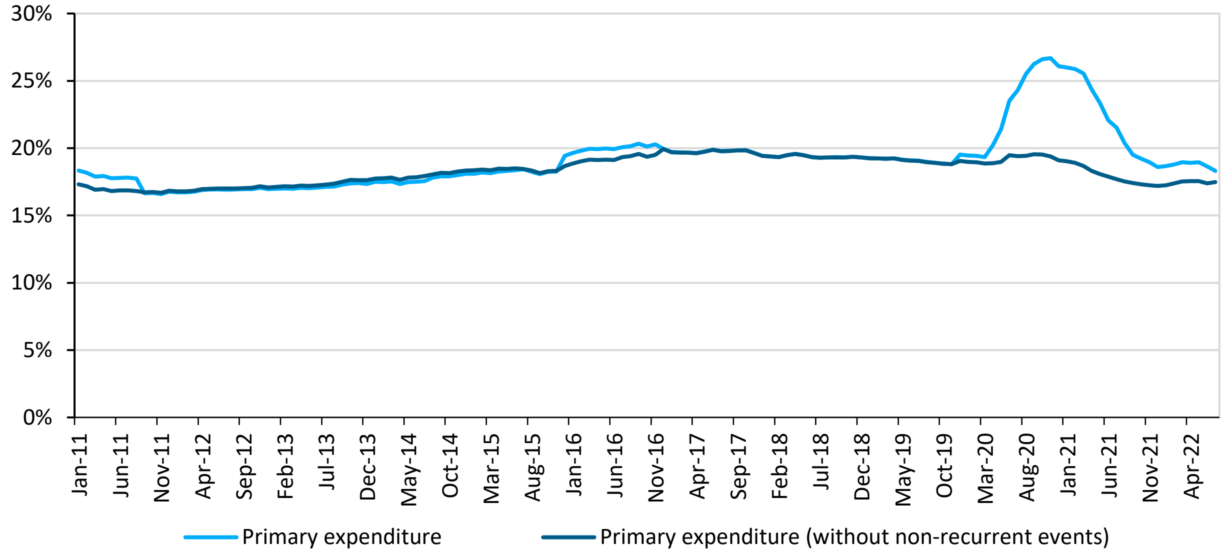
The IFI's projection for the central government's primary expenditure in 2022 is practically unchanged. In the 12-month comparison, total primary expenditure reached R$ 1,698.9 billion (18.3% of GDP) in July, a reduction of 13.7% compared to the same month in 2021. The IFI's projection for the variable in 2022 rose from R$ 1,825.2 billion (18.8% of GDP) to R$ 1,827.8 billion (18.8% of GDP). By comparison, the median of the projections compiled by the Prisma Fiscal Report, August 2022, is R$ 1,804.2 billion, while the government's estimate in the latest Bimonthly Report on Primary Revenue and Expenditures is R$ 1,833.7 billion.

The increase in the projection of the central government's primary expenditure of R$ 2.5 billion in 2022 was motivated by the incorporation of the spending related to the Culture Support Law (Paulo Gustavo), the revision in the macroeconomic scenario parameters, and the adjustment to the data already released, such as those related to extraordinary credits.

Recurrent primary expenditure calculations show that the central government's primary expenditure remains controlled. Figure 9 presents the 12-month evolution of total realized primary spending and the recurrent spending calculated by the IFI according to the methodology presented in EE No. 17, 2021. The total primary expenditure reached 18.3% of GDP in July (18.6% in June and 19.0% in May), while the spending without the non-recurring events reached 17.5% (17.4% in June and 17.5% in May). Both curves indicate that primary expenditure remains relatively under control.

The fiscal space opened in 2022 with Constitutional Amendments No. 113 and 114, as well as Constitutional Amendment No. 123 of 2022, will slow the pace of reduction of primary expenditure as a proportion of GDP. The IFI's projection is for primary spending at 18.8% of GDP by the end of 2022. The drop observed in recent months is explained to a greater extent by the substantial increase in nominal GDP and, to a lesser extent, by the absence of adjustments to public servants since 2019.

FIGURE 9. TOTAL PRIMARY EXPENDITURES (WITH AND WITHOUT NON-RECURRING EVENTS) - % OF GDP



Source: STN. Prepared by IFI.

2.3 The central government and the consolidated public sector balance

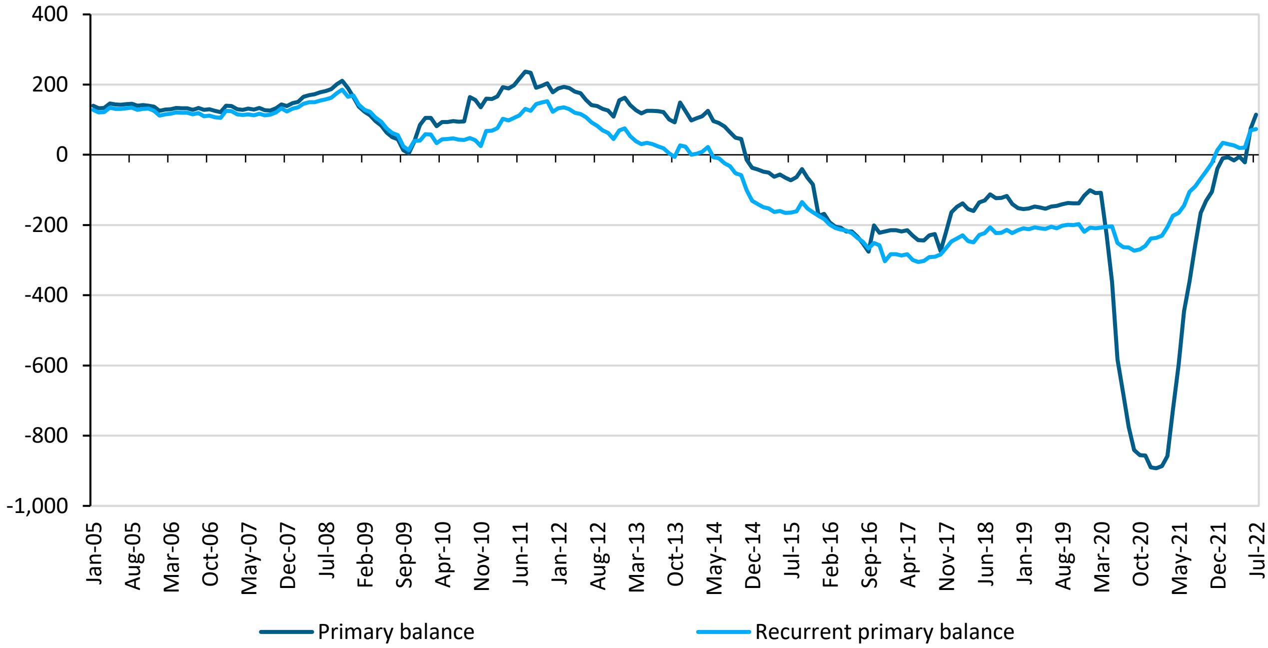
Preliminary data from the Siga Brasil portal show a primary surplus of R$ 18.4 billion for the central government in July, compared to a deficit of R$ 19.5 billion in the same month last year. In the year to date, the central government has a surplus of R$ 72.0 billion, determined by a combination of growth in tax collection and relative control of primary spending.

The IFI's projection for the central government's primary balance in 2022 was updated to a surplus of R$ 27.0 billion. In the 12 months ending in July, the central government had a primary surplus of R$ 110.0 billion (1.2% of GDP). The IFI's projection for the 2022 primary surplus went from a R$ 40.9 billion deficit (0.4% of GDP) to a R$ 27.0 billion surplus (0.3% of GDP). The market consensus captured by the August Prisma Fiscal Report is for a primary surplus of R$ 4.6 billion this year, while the average of the houses that make up the report's podium is R$ 34.1 billion. According to the Bimonthly Report of Revenues and Expenditures released in July, the Executive Branch expects a primary deficit of R$ 59.3 billion in 2022.

This increase in the IFI's projection for the primary balance of the central government in 2022 is due to the upward revision of expectations for net revenue (by R$ 70.4 billion, from R$ 1,784.3 billion to R$ 1,854.7 billion). The projection for primary expenditure was revised upward by R$ 2.5 billion, from R$ 1,825.2 billion to R$ 1,827.8 billion.

Figure 10 shows the 12-month path of the central government's conventional (observed) and recurrent primary balances at July 2022 prices. While the traditional balance was a surplus of R$ 114.5 billion, the recurrent one was positive at R$ 73.5 billion. The recurring result confirmed an improvement in the trajectory of the Federal government's primary surplus as of the last quarter of 2020, when tax collection started to thrive.

FIGURE 10. CENTRAL GOVERNMENT´S PRIMARY BALANCE (R$ BILLION AT JULY 2022 PRICES)



Source: STN, Siga Brasil and Tesouro Gerencial. Prepared by: IFI.

As mentioned earlier, the expected slowdown in domestic and external economic activity in the coming months due to tighter monetary policy is a risk to the trajectory of revenues, especially from 2023. The IFI will continue to monitor these risks promptly.

Before moving on to the analysis of the information released by the Central Bank, calculated using the below-the-line methodology[6], a few remarks about Table 5, which presents a comparison between the observed values for some variables (total and net revenues, transfers, total expenditures, and primary balances) of the central government released in the RTN and collected by the IFI in Siga Brasil. The objective is to present the deviation between the values based on the filters considered in the search made in Siga Brasil.

Deviations between the values collected in Siga Brasil and the observed values are smaller in primary expenditures. In April 2022, the most significant divergence between the matters contained in Siga Brasil and those later presented by the Treasury in the RTN was in total primary revenue (R$ 1.1 billion), which influenced the estimate calculated for net revenue (deviation of R$ 1.4 billion) that month. The most considerable variations in May and June occurred in revenues and transfers (from R$ 200 million to R$ 400 million). The IFI has sought to improve the filters of the Siga Brasil queries so that the deviations reported in Table 5 are increasingly smaller.

[6] For a more detailed explanation, access the RTN Manual of Fiscal Statistics: https://bit.ly/3pjxgEv.

TABLE 5. COMPARISON BETWEEN THE MONTHLY VALUES REPORTED IN THE RTN AND THE VALUES OBTAINED IN SIGA BRASIL (R$ BILLION)

	Apr/22			May/22			Jun/22		
	RTN [A]	Siga [B]	Dif. [A-B]	RTN [A]	Siga [B]	Dif. [A-B]	RTN [A]	Siga [B]	Dif. [A-B]
Primary revenue	198.53	197.44	1.09	172.88	172.60	0.28	224.26	224.04	0.22
Transfers by revenue sharing	32.45	32.74	-0.29	50.84	50.80	0.04	33.69	33.25	0.44
Net revenue	166.08	164.70	1.38	122.04	121.80	0.25	190.57	190.79	-0.22
Primary expenditure	137.18	136.74	0.44	161.40	161.23	0.18	176.13	176.10	0.03
Primary balance	28.90	27.96	0.94	-39.36	-39.43	0.07	14.44	14.69	-0.25

Source: STN and Siga Brasil. Prepared by: IFI.

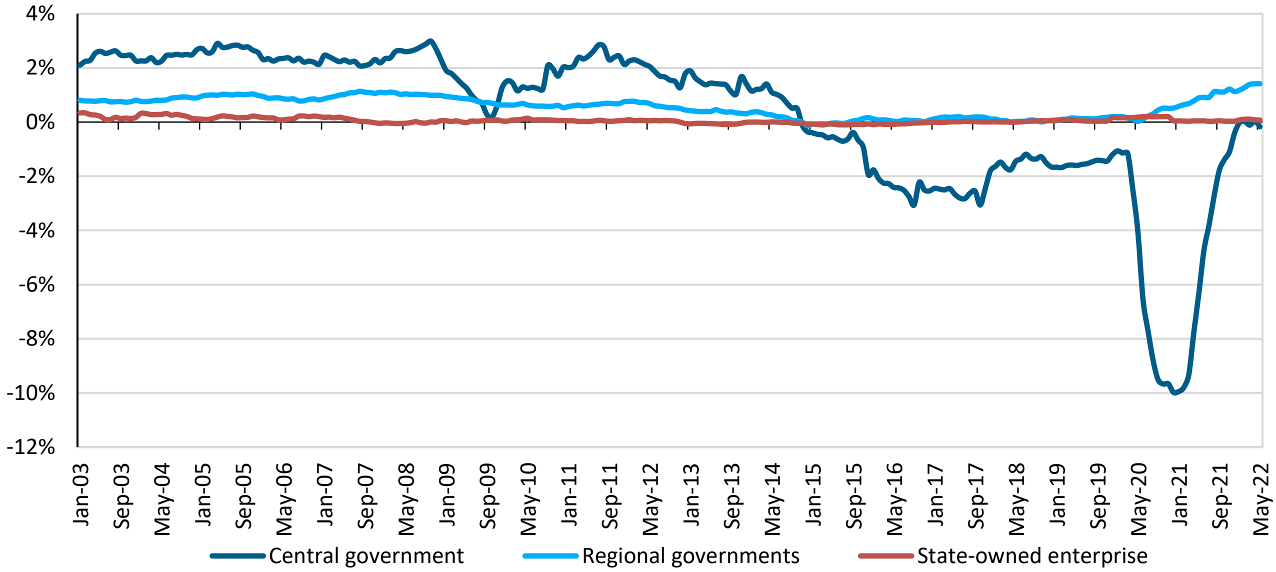
We now analyze the data made available by the Central Bank, updated to May 2022, regarding the consolidated public sector primary and nominal balances.

Regional governments continue to account for the most significant portion of the public sector's accumulated primary surplus in 2022. The public sector, including the federal government, regional governments, and state-owned companies, had an accumulated primary surplus of R$ 115.5 billion in 2022, compared to a R$ 60.3 billion surplus in 2021. The central government accounted for a surplus of R$ 40.1 billion in 2022 until May, while the states and municipalities accumulated a positive result of R$ 69.7 billion and state companies another R$ 5.8 billion.

In the 12 months ending in May, the public sector had a primary surplus of R$ 119.9 billion (1.3% of GDP), according to the Central Bank. Of this amount, the central government (federal government, Central Bank, and INSS) was responsible for a deficit of R$ 15.7 billion (0.2% of GDP), while the regional governments (states and municipalities) and state companies had surpluses of R$ 128.7 billion (1.4% of GDP) and R$ 6.9 billion (0.1% of GDP), respectively. This information is presented in Figure 11.

The ICMS tax rates reduction on some items will affect the subnational entities' collection and primary balances in the year's second half. Also, Figure 11 shows that the primary surplus of the regional governments was stable between April and May, at 1.4% of GDP. In the second half of the year, the innovations brought about by Supplementary Law (LC) No. 194 of June 23, 2022, namely, the classification of telecommunications, electricity, fuels, and public transportation as essential goods and services, will reduce the collection of subnational entities and decrease the primary surplus accumulated for the year.

FIGURE 11. CENTRAL GOVERNMENT, REGIONAL GOVERNMENTS, AND STATE-OWNED ENTERPRISE'S PRIMARY BALANCE - % OF GDP



Source: Banco Central. Prepared by: IFI.

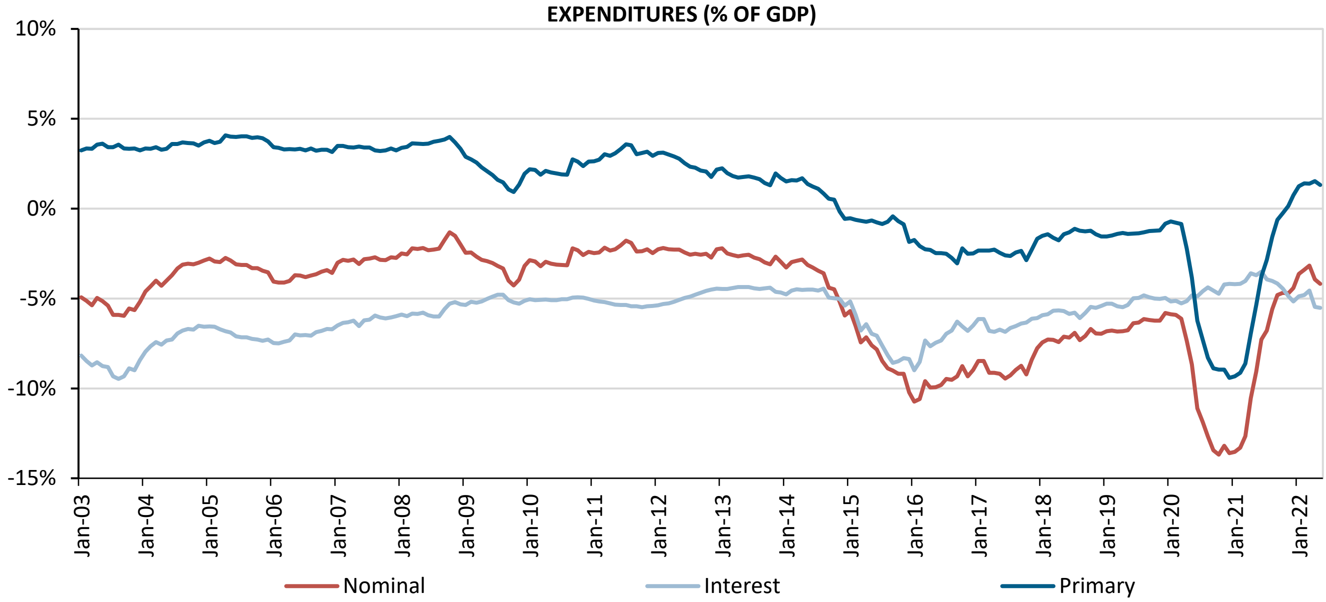
Considering the nominal result of the public sector, which includes the primary balance and the payment of interest on the public debt, there was a deficit of R$ 380.6 billion (4.2% of the GDP) in the 12 months ending in May. Figure 12 presents this information. The composition of this deficit was as follows: nominal central government deficit of 5.0% of GDP; regional government surplus of 0.9% of GDP; and state companies' surplus of 0.02% of GDP.

Interest Expenditure as a proportion of GDP has maintained an upward trend since mid-2021. Still considering the 12-month comparison, public sector interest expenditures reached 5.5% of GDP (or R$ 500.5 billion) in May, against 5.5% of GDP (R$ 489.4 billion) in April and 3.7% of GDP (R$ 295.6 billion) in May 2021 (Figure 12). Interest expenditures as a proportion of GDP reversed the downward trajectory in July of last year when it assumed an upward trajectory. This movement is related to the monetary tightening started by the Central Bank in March 2021. The prospect is that interest expenses will continue to rise in the coming months as the average cost of public debt continues to increase.

The nominal public sector deficit as a proportion of GDP started to rise in April. It is also important to mention that the increase in interest expenses has begun to affect the evolution of the nominal public sector result. Based on a comparison over 12 months, the nominal deficit fell until March 2022, when it registered 3.2% of GDP. In April, the indicator rose to 3.9% of GDP and then to 4.2% in May (Figure 12).

As highlighted in previous issues of this RAF, the expected growth in interest expenses as a proportion of GDP would affect the trajectory of the nominal result, making it necessary to generate higher primary surpluses to keep the nominal result in decline. Furthermore, higher interest expenses make it more challenging to stabilize the debt levels, requiring higher primary results to stabilize the gross debt as a proportion of GDP.

FIGURE 12. CONSOLIDATED PUBLIC SECTOR PRIMARY AND NOMINAL BALANCES AND INTEREST EXPENDITURES (% OF GDP)



Source: Central Bank. Prepared by: IFI.

2.4 Public sector indebtedness indicators

The global environment of a lower growth prospect and higher interest rates increases uncertainties and worsens risk perception. In June and July, the worsening risk perception by agents affected the future interest rate curve. The deterioration in expectations occurred due to the high global inflation environment and the downward revisions in economic growth this year and next. At the same time, central banks have adopted a harsher tone in dealing with inflation, reinforcing the perception of a slowdown in global growth.

In August, dollar-denominated commodity prices retreated to the levels of early March. Commodity prices have already retreated and are at the levels registered in the first half of March. As an illustration, the Brent crude oil barrel price was trading below US$ 100, at the US$ 96 level on August 3. The combination of a slowdown in global economic activity, higher interest rates, and a reduction in commodity prices may reinforce the deterioration in expectations regarding the performance of emerging economies such as Brazil.

Fiscal measures increase uncertainties regarding the domestic environment by posing risks to the sustainability of public accounts. The combination of an external environment as described above and the uncertainties produced by the fiscal policy actions adopted in recent months may lead to more significant challenges to the Treasury in managing public debt, given the increased risks associated with the sustainability of public finances in the medium and long term. As discussed below, the primary surplus projected by the IFI for the horizon up to 2031 is insufficient to guarantee the stabilization of the General Government Gross Debt (DBGG) as a proportion of GDP. The risks associated with eventual increases in primary expenditures or fiscal renounces, whether permanent or transitory, will continue to be monitored by the IFI.

The first step is to analyze the information in the Monthly Debt Report (RMD), issued by the National Treasury Secretariat, with data updated up to June.

The outstanding Federal Public Debt (DPF) increased by R$ 143.3 billion in June compared to May, reaching R$ 5,845.5 billion. The Domestic Federal Public Debt (DPMFi) stock rose R$ 119.4 billion to R$ 5,595.4 billion, while the External

Federal Public Debt (DPFe) rose R$ 226.3 billion to R$ 250.2 billion. The outstanding of all components of the DPMFi increased from May to June: R$ 40.1 billion in fixed-rate securities, R$ 30.9 billion in inflation-linked securities, R$ 46.1 billion in floating-rate securities, and R$ 26.1 billion in FX-linked securities.

In primary market transactions, net issuances of DPF totaled R$ 67.3 billion in June (issuances of R$ 71.3 billion and redemptions of R$ 4.0 billion). Historically, June is a month with a low volume of bond redemptions. In 2022, issuance volume was similarly low compared to previous months.

In the DPMFi, net issuance also totaled R$ 67.3 billion in June, with the predominance of fixed-rate securities (net issuance of R$ 29.5 billion) and floating-rate securities (R$ 24.5 billion). Issuance of inflation-linked securities was R$ 13.3 billion higher than redemptions.

Redemptions exceeded issuances in the first half of the year. In the first half of the year, there was a net redemption of R$ 57 billion in DPMFi securities, with a high concentration of rescues in January (R$ 143 billion), March (R$ 271 billion), and April (R$ 129 billion). The higher amount of redemptions to DPMFi issues in the accumulated 2022 through June is related to the Treasury's management of the liquidity reserve, as will be explored below.

According to the STN, the public debt liquidity reserve was R$ 1,221.4 billion in June, against R$ 1,108.0 billion recorded in May. In June, the indicator stood at R$ 1,167.1 billion. The liquidity reserve (also called liquidity cushion) integrates the Treasury's available cash deposited in the Single Account at the Central Bank.

The Treasury's capacity to honor public debt maturities increased in June compared to May. The liquidity index, which corresponds to the sufficiency of cash to cover the maturities ahead of the DPMFi, reached 9.75 months in June, compared to 9.47 months in May. In other words, in the absence of new issuances in June, the Treasury would be able to pay 9.75 months of DPMFi bond maturities. For the next twelve months, DPMFi maturities are forecast at R$ 1,326.6 billion.

Higher levels of liquidity reserve than projected allowed the Treasury better to manage the debt in the year's first half. In the first half of 2022, the Treasury could reduce security issuances as the liquidity reserve reached higher than initially projected in the 2022 Annual Borrowing Plan (PAF). On the expenditure side, this more favorable scenario for the liquidity reserve in 2022 occurred due to higher primary surplus generation by the central government, which reduces the need to cover the deficit with liquidity cushion resources.

Higher collection of some unmanaged revenues and the Central Bank's operating result have affected the Treasury's liquidity reserve. On the revenue side, the liquidity reserve was positively impacted in 2022 by the following events: (i) an inflow of R$ 73 billion more from the Central Bank's operating result in February than the Treasury had planned for the year; (ii) an R$ 47 billion more untying of resources from public funds than the strategy outlined in the PAF for 2022; and (iii) an inflow of R$ 19 billion more from dividends than planned for the year. The combination of these events guaranteed an amount of R$ 139 billion more in the liquidity reserve in 2022 than planned.

Average DPMFi issue rates continued to rise in June. Average DPMFi issue rates maintained an upward trend in June, according to information presented by the STN in the RMD. For 24-month fixed-rate securities (LTN), the average issue rate was 13.30% p.a. in June, against 12.85% p.a. in May and 12.60% p.a. in April. In 48-month fixed-rate bonds, the rate was 12.75% p.a. in June, compared to 12.35% p.a. in May and 12.13% p.a. in April. In the 10-year fixed-rate bond, with semi-annual interest payments, the average issue rate rose from 12.61% p.a. in May to 13.11% p.a. in June.

IFI survey on auctions conducted by the Treasury indicates new increases in bond issue rates in July. Information gathered by the IFI regarding auctions held by the Treasury [7] indicates further increases in the rates of the DPMFi auctions in July. For example, a fixed-rate bond maturing on April 1, 2023, had an average issue rate of 14.01% p.a. in July, against 13.55% p.a. in June and 13.44% p.a. in May. For the fixed-rate bond maturing on July 1, 2025, the average issue rate went from 12.33% p.a. in May to 12.55% p.a. in June and 12.83% p.a. in July. The securities (and their respective maturities) are reported quarterly by the Treasury and may change over time.

Higher debt issue rates reflect uncertainties and increased risk perception. The increase in DPMFi bond issue rates in recent months characterizes an increase in the perception of risk by agents that finance the Brazilian public debt. Even though the global economic context is one of higher average interest rates in the medium term, the fiscal policy conducted in recent months may have contributed to a loss of credibility of the regime, encouraging higher premiums by debt financing agents in the auctions held by the Treasury.

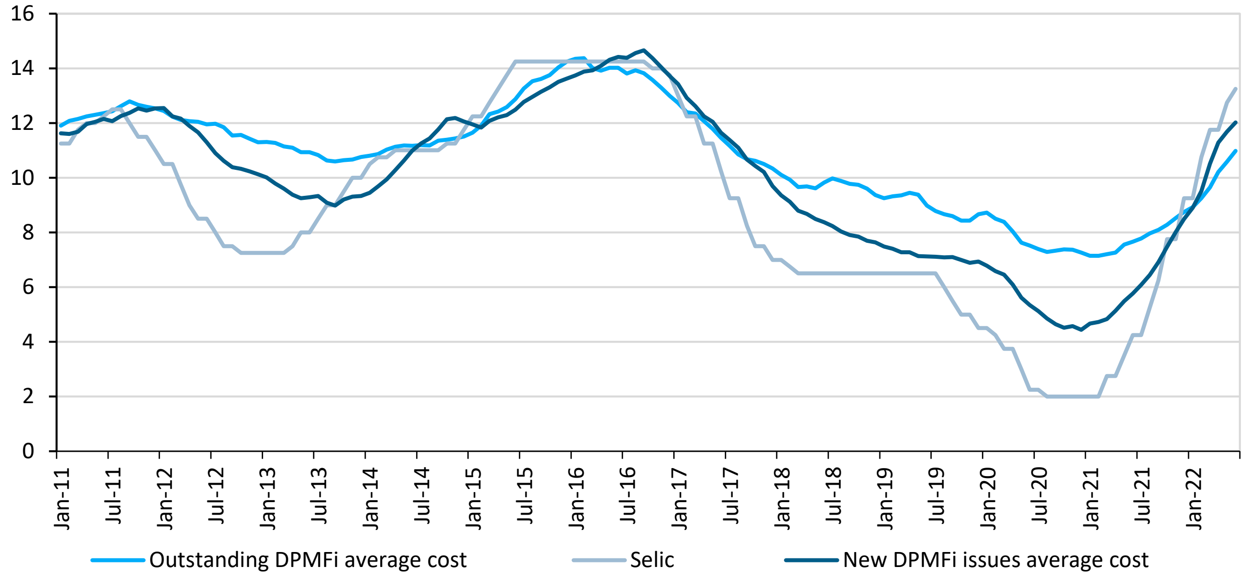
The Federal Public Debt outstanding average cost remained on the rise in June. To conclude the analysis of debt indicators contained in the RMD, the outstanding DPMFi average cost accumulated in 12 months rose 0.39 p.p. in June, compared to May, to 10.98% p.a., the sixteenth consecutive increase in the monthly comparison. Compared to June 2021, the DPMFi outstanding average cost rose 3.32 p.p. (Figure 13).

The average cost of DPMFi public offerings also rose in June to 12.03% p.a., compared to 11.69% p.a. in May (a 0.34 p.p. increase). By June 2021, the average cost of DPMFi issues grew by 6.26 p.p. (Figure 13).

The higher average cost of the debt reflects increases in bond indexing factors, and stabilization is expected to occur when the Central Bank ceases the cycle of interest rate hikes. The increase in the DPMFi outstanding and new issues average cost as of March 2021 appeared in line with the growth registered in the indexing factors for securities (inflation and the Selic rate). The increase in inflation has forced the Central Bank to adopt a contractionary monetary policy. In the last Monetary Policy Committee (Copom) meeting, the Selic was raised to 13.75% p.a. In the statement released after the decision, Copom left open the possibility of a new rate hike in the September meeting of the collegiate. The IFI expects the rate to close in 2022 at this value, the same projection of the median market expectations captured by the Central Bank's Focus survey of August 5, 2022. The average cost of DPMFi issuances tends to stabilize when the interest rate tightening cycle is interrupted.

[7] Available at: https://www12.senado.leg.br/ifi/dados/dados.

FIGURE 13. THE AVERAGE COST OF PUBLIC DEBT (OUTSTANDING AND NEW ISSUES) AND SELIC RATE



Source: STN. Prepared by: IFI.

Gross Debt fell in May in monthly and annual comparisons. The indebtedness indicators released by the Central Bank (methodology below the line), with information updated up to May, the General Government Gross Debt (DBGG) reached 78.2% of the GDP (R$ 7,098.5 billion) that month, a reduction of 0.8 p.p. to April and another of 5.7 p.p. to May 2021 (Figure 14). Also, according to the Central Bank, this reduction in the indicator in May occurred due to nominal GDP growth (-1.0 p.p.), net redemptions of debt (-0.3 p.p.), the exchange rate appreciation (-0.2 p.p.), and the accrued nominal interest (+0.7 p.p.).

The reduction in gross debt as a proportion of GDP in 2022 mainly reflects the increase in nominal GDP and net redemptions of securities. In the accumulated 2022 until May, the GGBD fell 2.1 p.p. of the GDP. This drop was due to the increase in the nominal GDP growth (-3.5 p.p.), net redemptions of debt (-1.2 p.p.), the accumulated exchange rate appreciation (-0.8 p.p.), and the accrued nominal interest (+3.5 p.p.). It is worth mentioning that net redemptions of debt do not necessarily mean difficulties for the Treasury in issuing securities to roll over the public debt. As mentioned before, the liquidity reserve has allowed the Treasury to maintain the original financing plan in 2022 without making significant issues in an environment of uncertainty and greater volatility.

IFI's projection for gross debt in 2022 has been changed to 78.8% of GDP. The IFI projects that the DBGG will end 2022 at the level of 78.8% of GDP (R$ 7,681.1 billion), against a previous projection of 79.4% of GDP. By 2023, the indicator is expected to rise to 80.4% of the GDP (R$ 8,353.0 billion). By comparison, the Ministry of Economy projects gross debt at R$ 7,559.1 billion (78.3% of GDP) at the end of 2022 and R$ 8,315.6 billion (78.5% of GDP) next year, according to the Fiscal Projections Report[8] released in June.

The discrepancy between the IFI's and the government's projections for the DBGG is due to the macroeconomic parameters used. While the IFI expects real GDP growth of 2.0% in 2022 and 0.6% in 2023, the government projects 1.5% growth for 2022 and another 2.5% next year. The IFI expects the Selic to reach 13.75% in December 2022 and 10.50% at the end of 2023, while the government projects 13.2% and 9.2%. Finally, the IFI's estimate for the public

[8] Available at: https://www.tesourotransparente.gov.br/publicacoes/relatorio-de-projecoes-fiscais/2022/20.

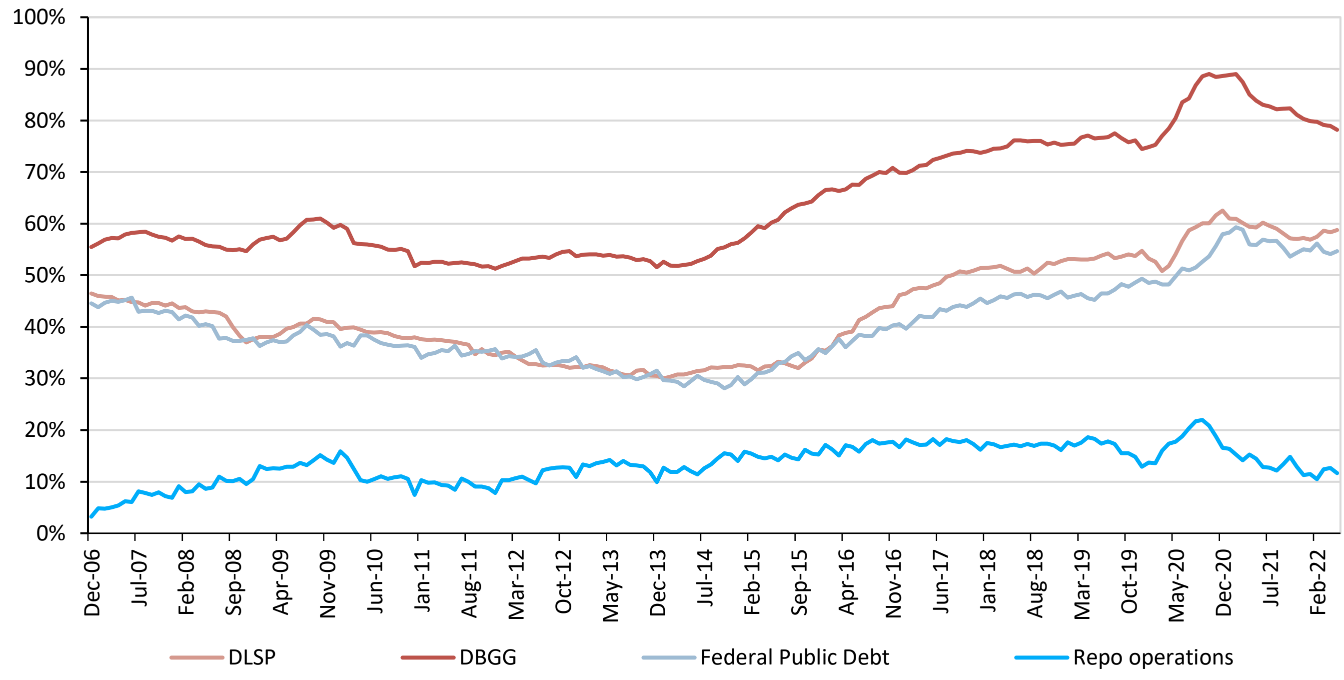
sector primary balance is 0.2% of GDP by the end of 2022 and 0.0% by the end of next year, while the government projects deficits of 0.1% and 0.3%.

The primary surplus required to stabilize the DBGG at 78.8% is 1.4% of GDP. Considering the debt sustainability equation, the primary balance necessary to stabilize the DBGG at the 78.8% of GDP level (IFI's projection for the variable at the end of 2022) would be a surplus of 1.4% of GDP, 0.6 p.p. of GDP higher than the current projection of the baseline scenario for the primary surplus of the consolidated public sector (0.8% of GDP).

The Net Public Sector Debt (DLSP) reached R$ 5,338.3 billion (58.8% of GDP) in May, up 0.5 p.p. when compared to April and a reduction of 0.4 p.p. when compared to the same month in 2021 (Figure 14). This movement in the net public sector debt in May was determined by the exchange rate appreciation of 3.9% exchange rate appreciation (+0.5 p.p.), the primary deficit (+0.4 p.p.), the accrued nominal interest (+0.4 p.p.), and the nominal GDP growth (-0.8 p.p.).

The increase in net debt as a proportion of GDP in 2022 was influenced mainly by the exchange rate appreciation and interest payments. In the accumulated five months in 2022, the DLSP as a proportion of GDP grew 1.6 p.p., reflecting the 15.3% accumulated exchange rate appreciation (+2.4 p.p.), the accrued nominal interest +2.1 p.p.), the exchange rate variation in the basket of currencies that make up the net external debt (+0.9 p.p.), the nominal GDP growth (-2.5 p.p.), and the accumulated primary surplus (-1.3 p.p.).

FIGURE 14. PUBLIC DEBT INDICATORS AND PRINCIPAL COMPONENTS (% OF GDP)

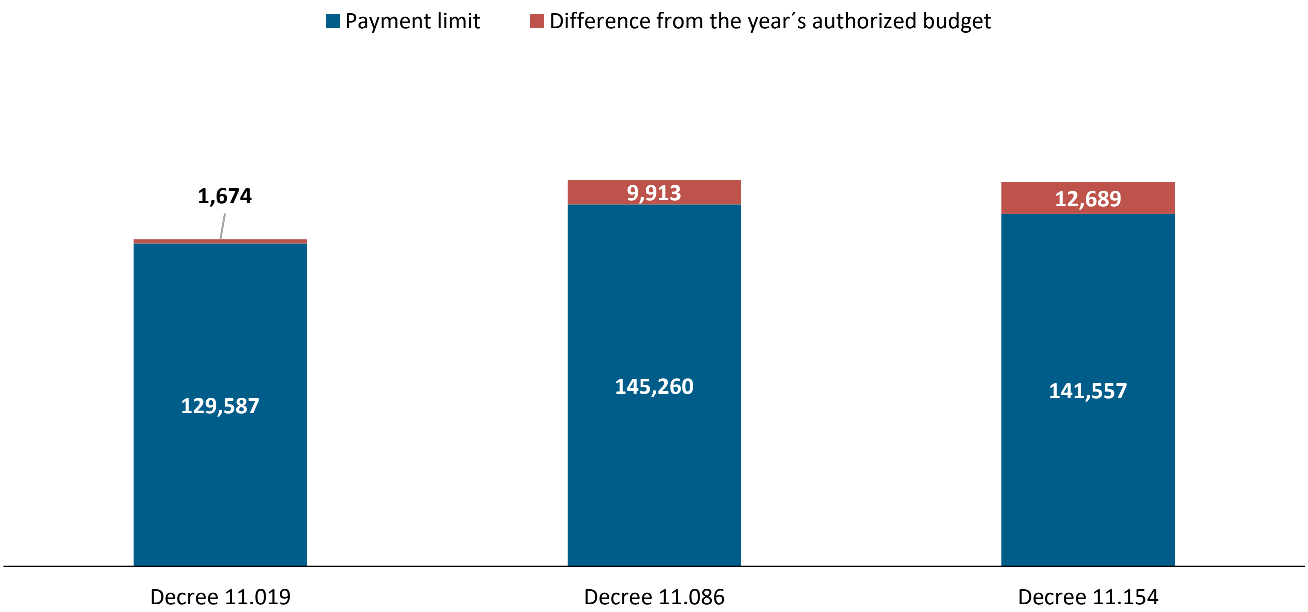


Source: Central Bank. Prepared by: IFI.

2.5 Executive financial programming after the 3rd bimester

To comply with the spending ceiling, the Executive has again reduced the discretionary spending forecast for 2022. On July 22, the Ministry of Economy released the Primary Revenue and Expenditure Assessment Report (RARDP) for the third quarter of 2022[9]. The report shows the main changes in the government's fiscal scenarios for the year. The prospect of improved tax collection remains in line with the dynamics analyzed by the IFI in this report. On the other hand, the need to adjust the budget to comply with the spending ceiling persists. As a result, Decree No. 11154 of July 29 limited the Executive's discretionary spending to R$ 141.6 billion (Table 6), R$ 12.7 billion below the year's authorized budget. Until the evaluation of the second bimester, this difference was R$ 9.9 billion (Figure 15).

FIGURE 15. EXECUTIVE´S DISCRETIONARY SPENDING IN 2022 (R$ MILLION)



Source: Decreee No. 10.961/2022 (and further changes). Prepared by: IFI.

Table 6 summarizes the estimates of revenues and expenses contained in the Annual Budget Law (LOA)[10] and Decree No. 10,961 of 2022 (the Executive's budget and financial programming decree), with the changes brought about by Decrees No. 11,019, 11,086, and 11,154 of 2022.

[9] Available at: https://sisweb.tesouro.gov.br/apex/f?p=2501:9::::9:P9_ID_PUBLICACAO:44149.

[10] The information regarding the Autograph can be accessed in: Volume I of Law No. 14.303, of January 21, 2022 (LOA). Available at: http://www.planalto.gov.br/ccivil_03/_ato2019-2022/2022/lei/anexo/L14303-22-Volume%20I.pdf (page 331)

TABLE 6. PRIMARY BALANCE AND THE CENTRAL GOVERNMENT SPENDING CEILING 2022 ESTIMATES (R$ MILLION)

Breakdown	Autograph	LOA	Decree 11.019	Decree 11.086	Decree 11.154	Dif.: Decree 11.154 and Decree 11.086
Total revenue	**2,030,520**	**2,030,520**	**2,118,013**	**2,167,129**	**2,226,143**	**59,014**
Transfers	386,401	386,401	431,927	444,711	451,770	7,059
Net revenue [A]	**1,644,119**	**1,644,119**	**1,686,086**	**1,722,418**	**1,774,372**	**51,954**
Total expenditure [B]	**1,723,470**	**1,720,286**	**1,751,270**	**1,777,946**	**1,820,990**	**43,044**
Social Security (RGPS)	777,717	777,717	778,064	788,693	789,648	955
Payroll	336,102	336,102	338,551	341,340	339,586	-1,754
Other mandatory without flow control	252,511	252,511	281,976	279,495	324,670	45,175
Mandatory with flow control	223,164	223,164	223,093	223,158	225,529	2,371
Discretionary	133,976	130,792	129,587	145,260	141,557	-3,703
Primary balance [C] = [A]-[B]	**-79,351**	**-76,167**	**-65,184**	**-55,528**	**-46,618**	**8,911**
Expenditures subject to the ceiling	**1,676,430**	**1,673,246**	**1,679,700**	**1,687,938**	**1,690,992**	**3,054**
Primary target	**-170,474**	**-170,474**	**-170,474**	**-170,474**	**-170,474**	**-170,474**
Spending ceiling	**1,679,573**	**1,679,573**	**1,680,993**	**1,680,993**	**1,680,993**	**1,679,573**

Source: Decreto No. 10.961/2022 (and further changes) and LOA. Prepared by IFI.

On average, the reduction of the limits is equivalent to 8.2% of the budget authorized for the discretionary ones (Table 7). The Ministries of Education and Health were the ones that suffered the most significant adjustments. In the first case, the difference between the payment limit and the year's budget was R$ 2.9 billion, 14.3% of the total. In Health, the amount was R$ 2.1 billion, 12.4% of the total. In relative terms, the Ministry of Communications presented the most considerable reduction (15.8%), followed by the Ministry of Tourism (15.3%) and the Central Bank (15.1%).

The reduction in the general rapporteur's amendments is equivalent to almost one-third of the total authorized in the budget. The budgetary and financial programming also includes parliamentary amendments. In the case of impositive amendments - individual and group - the Constitution allows a limitation only if the fiscal estimates indicate that the primary balance target is not met[11], which does not occur in 2022. The committee and general rapporteur amendments do not have the same protection. In Decree No. 11,154 of 2022, the reduction of the committee amendments represents 64.6% of the amount authorized in the budget. In the case of the general rapporteur's modifications, the decline was R$ 5.6 billion, 33.8% of the total approved.

Table 7 details the programming of the Executive's discretionary spending by agency according to Decree No. 11,154, 2022.

[11] Impositive amendments are regulated in §§ 11 to 20 of art. 166 of the Federal Constitution.

TABLE 7. EXECUTIVE BRANCH DISCRETIONARY SPENDING PROGRAMMING BY ORGAN (R$ BILLION)

Agency (code/description)	Allocation (A)	Limit (B)	Dif. (A-B)	Dif. % ((A-B)/A*100)
41000 Ministry of Communications	1.3	1.1	0.2	15.8
54000 Ministry of Tourism	0.6	0.5	0.1	15.3
83000 Central Bank of Brazil	0.3	0.3	0.0	15.1
26000 Ministry of Education	20.6	17.7	2.9	14.3
35000 Ministry of Foreign Affairs	2.0	1.7	0.3	13.8
20000 Presidency of Brazil	0.4	0.4	0.1	12.7
36000 Ministry of Health	17.1	15.0	2.1	12.4
39000 Ministry of Infrastructure	6.9	6.2	0.7	10.3
52000 Ministry of Defense	11.2	10.0	1.1	10.1
32000 Ministry of Mines and Energy	2.1	2.0	0.1	4.9
30000 Ministry of Justice and Public Security	2.7	2.6	0.1	4.8
55000 Ministry of Citizenship	4.3	4.2	0.1	2.8
22000 Ministry of Agriculture, Livestock, and Supply	2.5	2.4	0.1	2.6
24000 Ministry of Science, Technology, and Innovation	6.8	6.7	0.1	1.2
40000 Ministry of Labor and Social Security	2.0	2.0	0.0	0.7
Others	39.4	40.8	-1.4	-3.6
Subtotal	120.3	113.6	6.7	5.6
Impositive amendments - individual (RP6)	10.9	10.9	0.0	0.0
Impositive amendments - group (RP7)	5.9	5.9	0.0	0.0
Committee amendments (RP8)	0.7	0.2	0.4	64.6
General rapporteur's amendments (RP9)	16.5	10.9	5.6	33.8
Total	154.2	141.6	12.7	8.2

Source: Decree No. 10,961/2022 (and further changes) and LOA. Prepared by: IFI.

2.6 2023 budgetary guidelines

On August 9, the President of the Republic sanctioned, with partial vetoes, the Bill of the National Congress (PLN) No. 5 of 2022 (PLDO 2023), resulting in Law No. 14,436 of August 9, 2022.[12] For the coming year, the Law foresees GDP growth of 2.5% and inflation measured by the IPCA of 3.3%. The primary result target is a deficit of R$ 65.9 billion (0.63% of GDP) for the consolidated public sector, composed of a R$ 69.0 billion deficit (0.66% of GDP) for the central government, a R$ 3.0 billion surplus (0.03% of GDP) for federal state companies, and a R$ 0.1 billion surplus for states and municipalities.[13]

In 2024, the projected deficit remains, although smaller than in 2023. In 2025, the LDO foresees a primary surplus of R$ 33.7 billion (0.28% of GDP) for the public sector, of which R$ 31.25 billion for the central government alone.

[12] The 2023 PLDO (PLN 5/2022) was approved on July 12, and the Autograph was sent to the presidential sanction on July 20. The proceedings, the Autograph, the approved text, and the vetoes can be seen at: https://www.congressonacional.leg.br/materias/pesquisa/-/materia/152731.

[13] Regarding the fiscal targets for the fiscal year 2023 to 2025, see the 2023 LDO Fiscal Targets Annex (Annex IV.1), available at: https://bit.ly/3w3mkii.

The Union will be able to exclude part of the expenses with court-ordered government debt payments from the primary surplus target. Innovation in the 2023 LDO concerns the treatment given to the new court-ordered government debt payments system. Constitutional Amendments No. 113 and 114, dated December 2021, allowed the court-ordered charges of government debt limitation. Furthermore, in some specific cases, the respective payment was exempted from the restriction related to the New Fiscal Regime (spending ceiling).

Due to these changes, the LDO provides for excluding expenses from the primary balance target calculation arising from the application of paragraphs 11 and 21 of the art. 100 of the Federal Constitution. These paragraphs allow for an "offsetting of accounts" between the creditor and the Union.[14]

A provision that allowed the primary spending target to be adjusted to the spending ceiling was vetoed. The spending ceiling for 2023 will be set based on 2022 inflation. Since the LDO uses outdated macroeconomic parameters, the actual spending limit may differ from the LDO foreseen. To get around this issue, and considering that the limit may result in higher expenses than the LDO, the PLDO autograph allowed the primary spending target adaptation to changes in the spending ceiling estimate. This was one of the provisions vetoed by the President because "it would weaken the primary balance target set in the Budget Guidelines Law for 2023 by bringing uncertainty about the primary result commitment of the Central Government".

2.6.1 Macroeconomic parameters

The Union LDO for 2023 foresees GDP growth of 2.5% and inflation of 3.3% (IPCA). The government's macroeconomic parameters, the basis for the revenues and expenses estimates contained in the annex of fiscal targets, are slightly different from the expectations of other economic agents (Table 8). The discrepancies, mainly in the inflation and GDP variables, indicate that the scenario outlined in the LDO should be revised in the 2023 Annual Budget Bill (PLOA) to be sent by the Executive Branch to the National Congress by the end of this month.

A comparison of the macroeconomic parameters set out in the LDO with those of the IFI, the Central Bank's Focus Survey, or the IMF's World Economic Outlook shows us that both from the revenue and expenditure points of view, the fiscal scenario may change. Lower expectations for economic growth, for example, can negatively influence the performance of revenues. On the other hand, expenses will be sensitized mainly by inflation, especially the inflation observed in the previous year.

[14] Suppose the creditor of the court-ordered debt is another federal entity (§ 21). In that case, the credit can be used to reduce installments in financing contracts, in contracts in which another federal entity is guaranteed, in tax installments, and obligations resulting from non-compliance with the rendering of accounts or deviation of funds. For other creditors (§ 11), the credit can be used to settle debts that have been paid in installments or registered as active debt, to purchase public real estate, to pay for the delegation of public services, to purchase the federative entity's shareholding, or to purchase rights made available for assignment by the federative entity.

TABLE 8. MAIN MACROECONOMIC PARAMETERS - 2023

Variables	Gov. (LDO 2023)	IFI (August)	Focus (08/15)	IMF
GDP – real growth (% a.a.)	2.5%	0.6%	0.4%	1.1%
Nominal GDP (R$ billion)	10,470.3	10,383.0	n.d.	n.d.
IPCA (% p.a.)	3.3%	5.0%	5.4%	5.1%
INPC (% p.a.)	3.3%	5.1%	n.d.	n.d.
Selic rate (% p.a.)	10.0%	10.5%	11.0%	n.d.
Exchange rate - average (R$ / US$)	5.3	5.2	5.2	n.d.
Nominal overall wages	4.3%	5.6%	n.d.	n.d.

Source: LDO 2023, Focus survey, World Economic Outlook – update Jul/2022 and IFI. Prepared by IFI.
Note: n.d. means not available.

2.6.2 Primary balance targets and spending ceiling

The LDO's fiscal targets annex aims to meet the Fiscal Responsibility Law (LRF) provisions. The annex sets current and constant annual targets for the year to which the LDO refers (2023) and the following years (2024 and 2025). The information includes revenues, expenses, nominal and primary balances, and public debt. By 2023, the Consolidated Public Sector's primary balance target is a deficit of 0.7% of GDP, and the nominal result, net, and gross debt are estimated, respectively, at 6.8%, 61.8%, and 79.6% of GDP.

On the other hand, the information referring to the spending ceiling is part of the fiscal risks annex. For 2023, the spending ceiling will correspond to the limit set for 2022, corrected by estimated inflation for 2022 plus the difference between estimated and actual inflation for 2021. This system for converting the spending ceiling stems from the constitutional changes made in Amendments No. 113 and 114, which, in addition to changing the system for court-ordered payments of government debt, also changed how the spending ceiling is corrected.

Thus, considering that the difference between the inflation estimate for 2022 foreseen in the SPE's parameter grid and the current market and IFI projections are high, the impact observed in the spending ceiling for the next year will also be increased.

The table below shows the spending ceiling foreseen in the 2023 LDO and calculated under other inflation assumptions for the next fiscal year. When comparing the spending ceiling predicted in the LDO with the spending ceiling that considers the IFI's inflation scenario, one can see that the aggregate impact of higher inflation (7.2% versus 6.6%) generates an increase in the spending ceiling of about R$ 10.8 billion.

TABLE 9. 2023 SPENDING CEILING UNDER DIFFERENT SCENARIOS

	2022 limit	Government (LDO 2023)	IFI (August)	Focus (08/15)
Executive	1,608,277	1,711,753	1,721,974	1,719,262
Legislative	14,510	15,444	15,536	15,512
Judiciary	49,947	53,161	53,478	53,394
Prosecutor's Office	632	673	677	676
Public Defender's Office	7,626	8,116	8,165	8,152
Total	**1,680,993**	**1,789,147**	**1,799,831**	**1,796,995**
Difference to 2022	-	108,154	118,838	116,003
Last year's IPCA	10.06%	6.55%	7.19%	7.02%

Source: LDO, IFI, and Focus survey. Prepared by IFI.

2.6.3 2023 LDO vetoes

Through Message No. 451, of August 9, 2022 (VET No. 45, of 2022),[15] the President of the Republic partially vetoed the PLDO 2023 approved by Congress on July 12, 2022.[16]

Most of the vetoes occurred because they were contrary to the public interest. The PLDO vetoes express the President's disagreement with the text approved by Congress. The prohibition arises when it is contrary to the public interest ("political") or when it is unconstitutional ("legal"). In the case, they were contrary to the public interest, except for Section III of Paragraph 2 of Article 81.

This clause provides that "among the procedures to be adopted in the budgetary and financial execution of the special transfers referred to in subitem I of the caput of art. 166-A, if the resources are not applied in the same financial year, they should be returned to the Union by January of the following year, except for the amounts entered as outstanding liabilities. "(VET 45/2022). In other words, it is understood to be unconstitutional since the rule would violate the provisions of item II of §2 of art. 166-A of the Constitution, which confers ownership of special transfers to the respective federative entity benefited.

The reasons for the other vetoes are presented as contrary to the public interest, with most of them having arguments that the vetoed provisions would increase budgetary rigidity or would be challenging to implement.

The possibility of adjusting the primary balance target to the spending ceiling adjustments was vetoed. The Head of the Executive Branch rejected the provisions of §3 of art. 2 of the 2023 PLDO, which states that: "The primary balance target to which this article refers may be altered by an amount equivalent to the variation in the total amount of the individualized limits established by art. 107 of the Transitory Constitutional Provisions Act [spending ceiling], as a result of the application of projection for the IPCA by the National Congress distinct from that used in the preparation of the 2023 Budget Bill." (PLN 5/2022).

In the reason for the veto, it was argued that the device would weaken the primary balance target by bringing uncertainty about the primary balance commitment of the central government. Another reason for the veto was that the device proposed the change only according to the impact of differences in the inflation forecast on expenditure, without considering its net effect on the primary balance, i.e., on revenues and expenses.

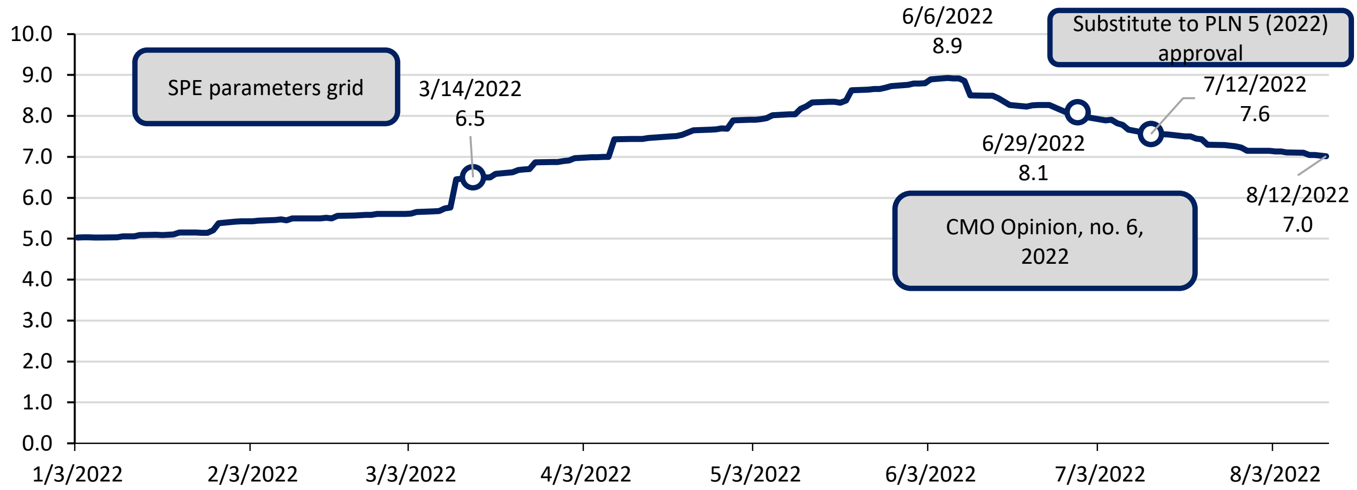
The device would allow changing the primary balance target for 2023, which was set at R$ 65.9 billion, by an amount equivalent to the variation in the total amount of the individual limits of the spending ceiling. In the case in question, the inflation estimate considered in the PLDO corresponds to the parameters grid of March 14, 2022, of the SPE, i.e., 6.55%[17]. However, in the period (end of June) when the PLDO rapporteur presented the report with a substitute, market forecasts pointed to higher inflation (8.1%). The figure below shows the IPCA 2022 market expectations, with marks referring to the dates of the SPE parameters grid, the substitute report to the PLDO, and the approval of the 2023 LDO.

[15] Message No. 451, of 2022. Partial Veto of National Congress Bill No. 5 of 2022 "**Provides the guidelines for the preparation and execution of the Budget Law of 2023 and makes other provisions**". Available at: https://www.congressonacional.leg.br/materias/vetos/-/veto/detalhe/15369.

[16] In the veto process, it is possible to follow the details of the vetoed commands, a summary of the rejected text, the reason for the veto, and synthetic justification. Available at: https://www.congressonacional.leg.br/materias/vetos/-/veto/detalhe/15369.

[17] Available at: https://www.gov.br/fazenda/pt-br/centrais-de-conteudos/publicacoes/conjuntura-economica/panorama-macroeconomico/2022/panmacro_spe_slides_-marco2022.pdf

FIGURE 16. MARKET FORECASTS - IPCA (2022)



Source: Central Bank´s Focus survey. Preapred by: IFI.

The impact that would be observed in the spending ceiling due to higher inflation could cause some limitations on account of the primary balance rule, i.e., depending on the updated projection of revenues, the expenses subject to the spending ceiling could be presented with some slack, for purposes of compliance with the primary balance target. To get around this issue, the Congress-approved text provided the possibility of incorporating the difference in calculating the spending ceiling in the primary balance target. Since the provision was vetoed, it is worth analyzing the feasibility of adjustments to the spending ceiling to the primary target.

Positive surprises in revenues and a reduction in inflation expectations should contribute to a better primary scenario than the one foreseen in the LDO. As shown in Figure 16, a decrease in inflation expectations contributes to a lower impact on indexed expenses. Additionally, the revenue estimates have increased to what was foreseen in the 2023 LDO since the scenario from March onwards has changed significantly.

2.7 The Judiciary Branch salary increase proposal

An 18% readjustment in the Judiciary remuneration would impact R$ 1.8 billion in 2023, R$ 5.5 billion in 2024, and R$ 6.3 billion from 2025 onwards. According to data from Siga Brasil, in 2021, R$ 34.8 billion were spent on paying salaries and charges in the Judicial Branch[18]. As an approximation of the fiscal impact of this possible readjustment starting in 2023, if we increase this value by 18%, we will reach R$ 41.1 billion in annual expenses, representing an increase of R$ 6.3 billion. An analogous calculation for the Public Ministry indicates an increase of R$ 1 billion (from R$ 5.4 to R$ 6.4 billion).

However, according [19] to the Supreme Federal Court (STF), the adjustments will be staggered and will take the form of 4.5% increases in April and August 2023 and in January and July 2024. To estimate the impact, we considered a

[18] Filter used to obtain the value, in the Siga Brasil Expert Panel: GND (Cod) = 1; Result Law (Cod) = all non-zero; Power DESP = Judicial Power; Year = 2021; Expense Element (Cod) = 1, 3, 7, 11, 12 and 13. See the value according to the "Paid" expense criterion.

[19] News on the STF website: https://portal.stf.jus.br/noticias/verNoticiaDetalhe.asp?idConteudo=492083&ori=1.

monthly expense of R$ 2.9 billion[20] and simulated the application of the staggered adjustment. Thus, in 2023 the total expenditure would reach R$ 36.6 billion, R$ 1.8 billion more than in 2021. In 2024, it would rise to R$ 40.3 billion (R$ 5.5 billion more than in 2021). Finally, in 2025, it would increase to R$ 41.1 billion (R$ 6.3 billion more than in 2021).

For the Public Prosecutor's Office, the figures would be: in 2023, total spending would rise to R$ 5.7 billion (+ R$ 284 million); in 2024, it would increase to R$ 6.3 billion (+ R$ 851 million); in 2025, it would rise to R$ 6.4 billion (+ R$ 972 million).

The readjustment of the Judiciary ceiling will also impact the other branches of government. The 18% increase, if implemented, will raise, in particular, the remuneration of the ministers of the STF, which is the salary ceiling of the Union's civil service. The income of R$ 39,293.32[21] would rise to R$ 46,366.12. Even assuming that there is no salary increase for the other careers, inside or outside the Judiciary, the new ceiling would lead some federal employees to obtain automatic salary gains. These servants have gross pay above the roof, but the portion that exceeds the limit is deducted from their salaries (the so-called "abate-teto"). With the increase in the salary ceiling, the amount deducted will be lower. That is, they will receive higher remuneration.

An estimate of the isolated impact of the ceiling reduction can be obtained from the Transparency Portal data[22]. According to this database, the total amount deducted in April 2022 (to take one month as an example), referring to the Executive Branch, was R$ 13.2 million, which, when annualized, would result in R$ 171.4 million[23]. As the base covers only the Executive, we increased this value to obtain all branches' estimates[24]. The final value obtained was R$ 205.3 million. The forecast may be below the actual impact because it was based on limited data, referring only to the Executive branch. Thus, we resorted to an adjustment of proportions to incorporate the other branches, a procedure that does not reflect the heterogeneity of salaries among them.

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[20] That is, the R$ 34.8 billion spent in 2021, divided equally over 12 months.

[21] It was fixed in 2018 by law 13.752/2018. Available at: http://www.planalto.gov.br/ccivil_03/_ato2015-2018/2018/lei/L13752.htm.

[22] Transparency Portal, maintained by the Comptroller General of the Union. Available at: https://transparencia.gov.br/download-de-dados/servidores.

[23] The data covers active civilian workers (effective or not), retirees and pensioners in the Executive Branch, and active military personnel and pensioners. More specifically, it covers data from the "Sistema Integrado de Administração de Pessoal" (SIAPE) and the Central Bank, in addition to the military, as mentioned. Each record in the base is a link to the Union, and one of the variables is called "abate-teto (R$)." Only 3,158 people had a non-zero "abate-teto" in April 2022. The impact consisted in calculating, for each person, how much of the savings allowance would be incorporated. We used only effective public servants for the calculations, and including non-effective servants would lead to a value of only 1% higher. The impact was annualized by multiplying the monthly value by 13.

[24] The increase consisted of separating the R$171.4 million into two parts: civilians and military personnel. Second, the part referring to civilians (R$ 126.7 million) was multiplied by an adjustment factor, equal to 1.27, to take into account people linked to the other Branches. This factor corresponds to the value referring to the Executive plus 27%, which is the proportion that the effective active civil servants of the other Branches represent the same group in the Executive (according to 2018 data from the Social Security Secretariat). In other words, it was an adjustment based on proportions. Third, we added the increased amount to the total for the military, thus reaching the total for the Union of R$205.3 million. Mathematically, these three steps are expressed as: [(R$ 126.7 million) × (1 + 145,105/543,618)] + (R$ 44.8 million) = [(R$ 160.5 million) × 1.27] + (R$ 44.8 million) = R$ 205.3 million per year.

IFI forecasts

SHORT-TERM

IFI forecasts	2022			2023		
	July	August	Comparison	July	August	Comparison
GDP – real growth (% per year)	1.43	1.99	▲	0.73	0.56	▼
Nominal GDP (R$ billion)	9,707.77	9,744.56	▲	10,360.76	10,382.95	▲
IPCA (% in the year)	7.43	7.19	▼	4.78	5.02	▲
Exchange rate – end-of-period (R$/US$)	5.18	5.26	▲	5.13	5.18	▲
Employment – growth (%)	6.00	7.06	▲	0.39	0.27	▼
Payroll – growth (%)	1.23	3.31	▲	0.82	0.56	▼
Selic rate – end-of-period (% per year)	13.75	13.75	=	10.25	10.50	▲
Real interest *ex-ante* (% per year)	6.06	6.10	▲	4.83	4.83	▼
Public Sector Consolidated Primary Balance (% of GDP)	0.58	0.88	▲	0.51	0.06	▼
of which Central Government	-0.42	0.28	▲	0.01	0.06	▲
Net Nominal Interest (% of GDP)	5.18	7.37	▲	5.30	6.31	▲
Nominal balance (% of GDP)	-4.60	-6.50	▼	-4.79	-6.25	▼
General Government Gross Debt (% of GDP)	79.42	78.82	▼	80.70	80.85	▲

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