Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

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HIGHLIGHTS

- GDP forecast in 2023 remains at 0.6% but would rise to 1.0% with the maintenance of fiscal stimuli.
- In an alternative scenario, considering the extension of the fuel exemption, inflation in 2023 would go from 4.9% (baseline) to 4.7%.
- Non-recurring expenses totaled R$ 60.1 billion in August 2022.
- Auxílio Brasil Program – Brazil Aid expense of R$ 600 does not fit into the federal spending ceiling for 2023.
- The central government's primary deficit could reach R$ 91.6 billion in 2023.
- Primary surplus of states and municipalities started to fall in June.
- Issuance rates at debt auctions dropped in July and August.
- Gross debt could reach 81.7% of GDP in 2023.
- Nursing wage floor would have an annual impact of R$ 5.5 billion in the public sector, concentrated in subnational entities.

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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.

In this RAF, we update the IFI's base scenario for 2022 and 2023, considering that the fiscal stimulus measures adopted this year will remain in place. In an alternative scenario, we contemplate the possibility of an extension to 2023 of these budgetary stimulus measures, namely tax benefits and an additional R$ 200 per month per family, referring to the Auxílio Brasil Program – Brazil Aid (PAB). In this context of uncertainty, the elaboration of alternative scenarios sheds light on the possible risks associated with the fiscal impact of these measures.

The first part of the RAF analyzes the macroeconomic context. The GDP growth estimate in 2022 moved from 2.0% to 2.6%. The second quarter data and the impact on the disposable income of the fiscal stimulus measures granted by the government support this outlook, even considering the adverse effects of the Selic rate and the slowdown already underway in the major economies. For 2023 the expectation is still for low growth, 0.6%, which could reach 1.0% with the eventual maintenance of fiscal stimuli, for the time being, foreseen only for 2022.

The labor market follows a recovery path. The unemployment rate fell again in July and now stands at 9.1%. The participation rate reached 62.7%, close to its level before the pandemic. Our average unemployment forecast in 2022 has dropped from 9.8% to 9.6%. The overall wages continue to be affected by high inflation, with an advance of 6.1% (real terms) to July 2021, without recovering the pre-pandemic level.

Inflation continues to drop after government measures. The Broad Consumer Price Index (IPCA) registered deflation of 0.36%, the second consecutive month in negative territory, and accumulated a twelve-month high of 8.73%. The reduction in fuel and electricity prices contributed to a new drop in administered prices (-2.55%). Moreover, free prices are already showing signs of deceleration, up 0.39% in August, compared to 0.65% in July, especially food-at-home, which slipped from 1.47% in July to 0.01% in August. The IPCA estimate in the baseline scenario for 2022 moved from 7.2% to 6.4%, and for 2023, from 5.0% to 4.9%.

The second part of the RAF deals with the fiscal environment. This month we raised the projection again for central government revenues due to the results until August and the higher growth expected for the economy in 2022. In this context, the IFI's forecast for the federal primary balance shows a surplus of 0.7% of GDP in 2022, compared to 0.3% in the previous scenario. In turn, the general government's gross debt should end the year at 78.0% of GDP, below the 78.8% projected in the August report.

We also analyze the effects of the extension of the validity of the fiscal stimulus measures on the federal accounts in 2023, namely, tax exemptions and the additional R$ 200 of the PAB. In particular, the extension of the additional R$ 51.8 billion of the PAB was estimated. If this amount is executed within the current spending ceiling, discretionary spending in 2023 would be reduced to a deficient level (from 1.1% to 0.6% of GDP). If the execution occurs outside the rule, the primary deficit will increase from +0.1% to -0.9%.

Finally, the report highlights the nursing floor. In this RAF, we estimate the potential costs of the nurse wage floor in the public and private sectors. In IFI's accounts, the annualized impact of the measure would be R$ 5.5 billion for the public sector and R$ 11.9 billion for the private sector.

Daniel Veloso Couri
IFI Executive Director

Vilma da Conceição Pinto
IFI Director

Summary

- We have raised the projection for the 2022 GDP from 2.0% to 2.6%. In an alternative scenario, maintaining the higher monthly benefit of the PAB program, the 2023 growth estimate would rise from 0.6% to 1.0%. The increase in disposable income offsets the more contractionary stance of monetary policy. In this scenario of a more significant stimulus to aggregate demand, the rise in fiscal risk affects the risk premium and inflation expectations over the relevant horizon of the Central Bank. For inflation, the extension of the fuel tax exemption may remove 0.5 p.p. from the IPCA projection for next year, although the resilience of aggregate demand would attenuate this effect. **(Page 7)**

- Data from Siga Brasil showed a non-recurring primary expenditure of R$ 60.1 billion in August. This amount corresponded to the payment of judgments and court-ordered debts, expenses with the electoral campaign, and the Union payment for the right to use Campo de Marte. Disregarding the effect of the R$ 60.1 billion in expenditures, the central government would have registered a primary surplus of R$ 8.3 billion in August, compared to the observed deficit of R$ 51.8 billion. **(Page 19)**

- The national wage floors for nursing professionals, established by law 14,434/2022, would have an annual impact of R$ 5.5 billion in the public sector, divided into R$ 26.9 million in the federal sphere, R$ 1.5 billion in the state sphere, and R$ 3.9 billion in the municipal sphere. The ongoing debate among federal authorities indicates that the Union may provide support to subnational entities so that they guarantee the profession's wage floor. For the private sector, eventual support from the Union could cost R$ 11.9 billion per year. Due to legal uncertainties and the absence of details about the design of the Union's support measures, the impact has not been incorporated into the IFI's fiscal scenarios. **(Page 19)**

- According to calculations made by the IFI, the primary deficit of the central government may reach R$ 91.6 billion in 2023 in a scenario of tax cuts of R$ 80.2 billion, included in the PLOA 2023, and the payment of the PAB in the amount of R$ 600 to 21.6 million families, an expense that does not fit in the Union's spending ceiling projected for next year. **(Page 25)**

- According to the Central Bank, the primary surplus of subnational entities accumulated over 12 months as a proportion of GDP had the second consecutive fall in July. Cross-referencing this information with tax collection data published by Confaz suggests that the deceleration in ICMS tax collection may have influenced this movement. In July, the ICMS revenues of the 27 states dropped in real terms compared to the same month of the previous year. This collection showed growth until June. **(Page 29)**

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1. MACROECONOMIC CONTEXT

After releasing the second quarter economic activity data, we raised our projection for the Gross Domestic Product (GDP) growth rate in 2022 from 2.0% to 2.6%. The employment and income indicators for July indicate an improvement in the labor market conditions, with more job openings and an expansion in the overall wages, boosting families' consumption.

The increase in disposable income resulting from aid programs[2] and tax exemptions on essential goods and services provides additional impetus to economic activity during the second half of the year, counterbalancing the adverse effects of the rise in the Selic rate and the activity growth slowdown in the major economies (United States, Europe, and China). The GDP growth deceleration in 2023 was maintained at 0.6%, reflecting the dissipation of the effects of reopening the economy and fiscal stimuli.

We adjusted the Broad National Consumer Price Index (IPCA) forecast to 6.4% in 2022 and 4.9% in 2023. The August IPCA showed some relief for consumer prices in the short term, reflecting the drop in fuel and energy taxes and the reduction in costs charged by Petrobras at its refineries, which follows the trend of oil prices in the international market. Despite remaining at historically high levels, commodity prices have been falling over the last few months as global demand is expected to weaken.

The Central Bank's Focus survey has been showing a downward movement in market projections for inflation in 2022 and 2023, while the outlook for the IPCA in 2024 (the horizon in which the Central Bank intends to generate convergence of inflation expectations) remains just above the target. We project that the Central Bank will end the cycle of interest rate hikes in the September meeting, with the Selic rate rising from 2.0% in March 2021 to the current 13.75%. Our scenario contemplates the Selic rate at the end of 2023 reaching 10.50%.

Even though there are no formal proposals to maintain the stimuli granted in 2022, in this edition of the RAF, we calculate the potential impact of an eventual continuation on macroeconomic variables. The Annual Budget Bill (PLOA) for 2023 did not contemplate maintaining the PAB in 2023 at R$ 600, although the Presidential Message that accompanies the bill mentions the government's intention of keeping, in 2023, the amount made possible by Constitutional Amendment 123.

Maintaining the higher monthly benefit of the PAB, the projection for GDP growth in 2023 would rise to 1.0%. The increase in disposable income for consumption offsets the negative vector resulting from a more contractionary monetary policy stance. In this scenario of more stimulus to aggregate demand, we assume that the increase in fiscal risk at the domestic level raises the risk premium, putting pressure on the exchange rate and on expectations over the horizon that the Central Bank intends to bring inflation to the target.

For inflation, we consider that the extension of the federal tax exemption on fuels would remove 0.5 p.p. from the IPCA projection for next year (through administered prices), although the resilience of aggregate demand on free inflation should attenuate this effect. In the alternative scenario, our projection for the IPCA in 2023 would decrease from 4.9% to 4.7% (Table 1).

[2] Considers the effects of the benefits granted under Amendment to the Constitution No. 123 of 2022.

TABLE 1. BASELINE AND ALTERNATIVE SCENARIO (BRAZIL AID AND FUEL EXONERATION)

IFI forecasts	2022	2023	
	Baseline	Baseline	Alternative
GDP – real growth (% per year)	2.6	0.6	1
IPCA (% in the year)	6.4	4.9	4.7
Exchange rate – end-of-period (R$/US$)	5.2	5.22	5.4
Selic rate – end-of-period (% per year)	13.75	10.5	11.5

Source: IFI.

1.1 Economic activity

GDP in current values totaled R$ 2.404 trillion in the second quarter, registering a nominal increase of 12.3% in comparison to the same period of the previous year. The release of the Quarterly National Accounts by the Brazilian Institute of Geography and Statistics (IBGE) showed that the GDP totaled R$ 2.404 trillion in current values (R$ 9.126 trillion accumulated in four quarters). Compared to the same period in 2021, the nominal GDP (monetary value of domestic production) rose 12.3%, reflecting the increase in the price level, according to the GDP price deflator (up 8.8%) and the 3.2% expansion of the real GDP (volume produced).

TABLE 2. NOMINAL GDP, VOLUME GDP, AND GDP PRICE DEFLATOR (QUARTER GROWTH RATE)

	Nominal GDP	Nominal GDP	Volume GDP	GDP price deflator
	(R$ trillion)	Quarter growth rate		
2019. IV	1.920	**5.50%**	**1.40%**	**4.00%**
2020. I	1.846	4.90%	-0.10%	5.00%
2020.II	1.722	-5.80%	-10.70%	5.50%
2020.III	1.888	0.40%	-3.70%	4.30%
2020. IV	2.011	**4.70%**	**-0.90%**	**5.70%**
2021. I	2.066	11.90%	1.30%	10.50%
2021.II	2.141	24.30%	12.30%	10.70%
2021.III	2.215	17.30%	4.00%	12.80%
2021. IV	2.258	**12.20%**	**1.60%**	**10.40%**
2022. I	2.249	8.90%	1.70%	7.10%
2022. II	2.404	12.30%	3.20%	8.80%

Source: IBGE. Prepared by: IFI.

Interannual growth of the GDP in volume (3.2%) followed the advance of services (supply) and household consumption expenditure (demand). On the supply side (or production), GDP growth in volume in the year-on-year comparison (3.2%) was driven by the expansion observed in services (4.5%) and, to a lesser extent, in the industry (1.9%), while the farming and livestock sector shrank 2.5%. In terms of demand (or expenditure), the most significant advance came from household consumption expenditure (5.3%), followed by gross fixed capital formation (1.5%) and government consumption expenditure (0.7%). In the external sector, exports of goods and services decreased by 4.8%, while the drop in imports of goods and services was 1.1% (Table 3).

TABLE 3. GDP GROWTH RATE

	The growth rate over the same quarter of the previous year			The growth rate over the last quarter (seasonally adjusted)		
	4Q-21	1Q-22	2Q-22	4Q-21	1Q-22	2Q-22
GDP	**1.6%**	**1.7%**	**3.2%**	**0.8%**	**1.1%**	**1.2%**
Supply						
Agriculture and livestock	-0.8%	-8.0%	-2.5%	5.9%	-0.9%	0.5%
Industry	-1.3%	-1.5%	1.9%	-0.9%	0.6%	2.2%
Services	3.3%	3.7%	4.5%	0.8%	1.1%	1.3%
Demand						
Household consumption	2.1%	2.2%	5.3%	1.0%	0.5%	2.6%
Government consumption	2.8%	3.3%	0.7%	0.8%	-0.1%	-0.9%
GFCF	3.4%	-7.2%	1.5%	0.1%	-3.0%	4.8%
Exports	3.3%	8.1%	-4.8%	-0.3%	5.7%	-2.5%
Imports	3.7%	-11.0%	-1.1%	0.7%	-4.0%	7.6%

Source: IBGE. Prepared by: IFI.

Contributions to the interannual growth rate of the GDP: domestic absorption (+4.1 p.p.) and net exports (-0.9 p.p.). We can split the GDP on the demand side into two parts: domestic absorption and net exports (exports minus imports), also called external absorption. Domestic absorption, which represents the sum of household consumption, government consumption, and investment, contributed 4.1 p.p. to the variation in the second quarter GDP, offsetting the negative influence of net exports (exports minus imports), which deducted 0.9 p.p. from the GDP's interannual result. Within domestic absorption, household consumption (3.1 p.p.) represented the main contribution to the GDP's interannual rate in the period, followed by the change in inventories (0.6 p.p.), gross fixed capital formation (0.3 p.p.), and government consumption expenditure (0.1 p.p.) – Table 4.

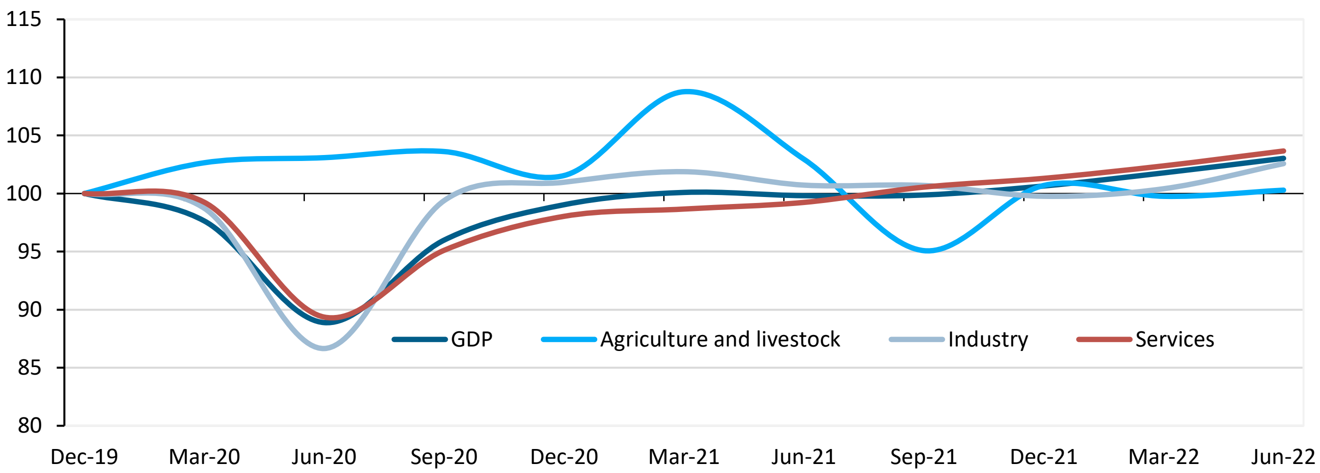
TABLE 4. CONTRIBUTIONS (P.P.) TO THE GDP ANNUAL GROWTH RATE

	1Q-21	2Q-21	3Q-21	4Q-21	1Q-22	2Q-22
GDP	**1.3**	**12.3**	**4**	**1.6**	**1.7**	**3.2**
Domestic absorption	**2.3**	**12.8**	**6.4**	**1.7**	**-1.9**	**4.1**
Household consumption	-1.1	6.4	2.6	1.3	1.3	3.1
Government consumption	-0.7	1.3	0.7	0.6	0.6	0.1
GFCF	2.9	5	3.1	0.6	-1.4	0.3
Changes in inventories	1.3	0.2	0	-0.8	-2.3	0.6
Net exports	**-1.1**	**-0.5**	**-2.4**	**-0.1**	**3.5**	**-0.9**

Source: IBGE. Prepared by: IFI.

GDP grew 1.2% in the first three months of 2022 in the seasonally adjusted series; carry-over to 2022 is estimated at 2.6%. Economic activity remained resilient in the passage from the first to the second quarter of 2022, exhibiting a 1.2% rise in GDP in the seasonally adjusted series, above our forecast (0.8%). Compared to the fourth quarter of 2019, the period immediately before the crisis caused by the Covid-19 pandemic, GDP is 3% higher (Figure 1). The solid second quarter result generated a statistical carry-over to 2022 of 2.6% – thus, if it remains stagnant in the second half, GDP would be up 2.6% for the year.

FIGURE 1. GDP - QUARTERLY VOLUME INDEX (DEC/2019= 100)SEASONALLY ADJUSTED DATA



Source: IBGE. Prepared by: IFI.

Supply. On the supply side, the most significant contribution came from the services sector (up 1.3%), which has benefited from the normalization of on-site activities and the improvement in labor market indicators. However, industry (2.2%), especially civil construction (2.7%), and the farming and livestock sector (0.5%), also contributed positively.

Demand. The GDP on the demand side followed the performance of gross fixed capital formation (4.8%), explained by civil construction, and segments benefited from increased commodity prices. The rise in household consumption expenditure (2.6%) reflected the positive effects of releasing FGTS funds and the anticipation of benefits typically paid in the second half of the year, in addition to the recovery of labor market conditions.

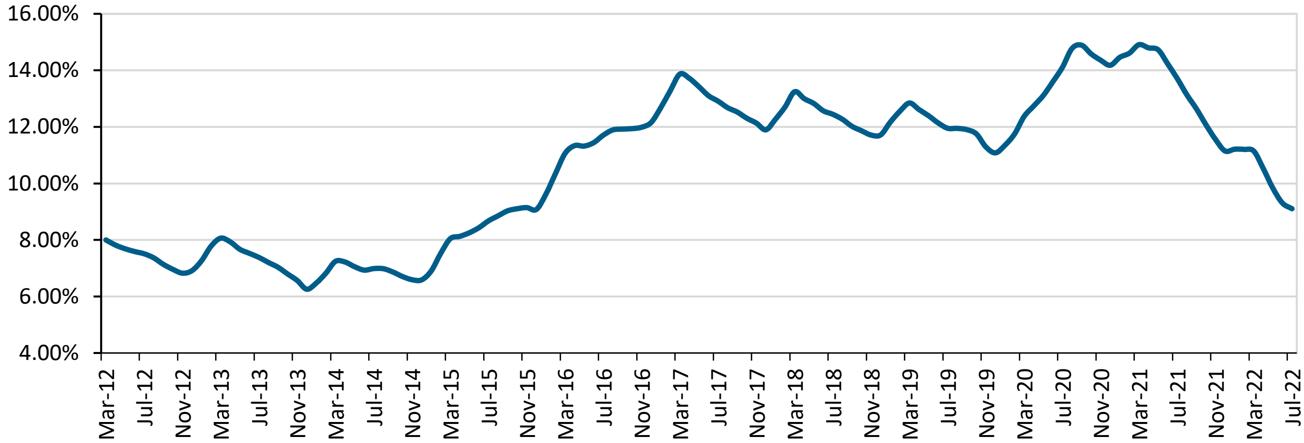
GDP is expected to grow 2.6% in 2022, slowing down to 0.6% in 2023. The IFI's annual GDP growth expected this year was adjusted from 2.0% to 2.6%, incorporating the positive dynamics of economic activity data in the short term. The increase in disposable income resulting from government aid programs and tax exemptions on essential goods and services brings additional strength to economic activity over the second half of the year, offsetting the harmful effects of the rise in the Selic rate and the slowdown in the growth of activity in major economies (United States, Europe, and China) – factors that reinforce the prospect of a slowdown in GDP in 2023. The lower expansion of domestic activity next year (projection maintained at 0.6%) is also limited by the dissipation of the effect of the reopening of the economy and the withdrawal of fiscal stimulus.

1.2 Labor market

Labor market data in July reinforces the resilience of economic activity. The data released by the IBGE in the Continuous National Household Sample Survey (PNAD Continuous) show the increase in the employed population in the formal sector of the economy and the decrease in the unemployment rate. Despite the wage drop in real terms, the increase in hiring is impacting the overall wages, contributing positively to the performance of household consumption.

The unemployment rate drops 4.1 p.p. in the year-on-year comparison. The unemployment rate reached 9.1% of the labor force in the quarter ended in July, 4.6 p.p. below the rate recorded in the same period a year earlier (13.7%), positioned at a lower level than in the months preceding the pandemic (Figure 2). We estimate that the average unemployment rate will reach 9.6% (revised from 9.8%) in 2022 and 10.2% (revised from 10.4%) in 2023, reflecting the worsening conditions in the labor market next year.

FIGURE 2. UNEMPLOYMENT RATE (% TOTAL LABOR FORCE)



Source: IBGE. Prepared by: IFI.

The reduction in the unemployment rate is the result of the growth in hiring – an employed contingent of 98.7 million people (an 8.8% expansion compared with the same period in 2021) – to a greater extent than that observed in the labor force (up 3.3% in the same comparison), composed of people who are employed or seeking employment (unemployed population).

TABLE 5. LABOR MARKET INDICATORS

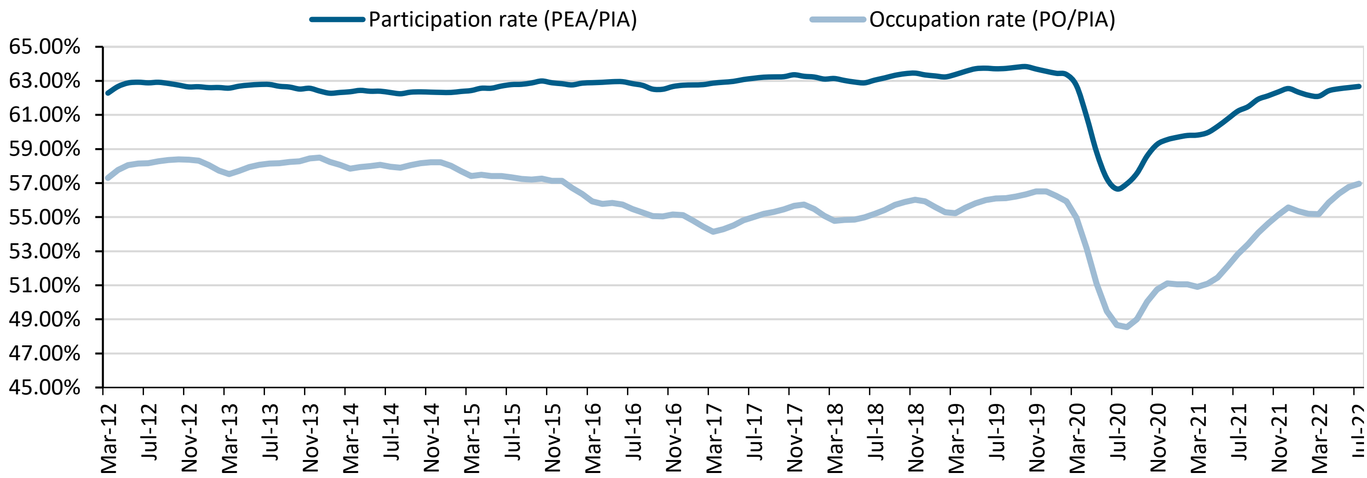
	Values (million)			Quarter x last quarter		
	Jul/20	Jul/21	Jul/22	Jul/20	Jul/21	Jul/22
A – Working-age population	170	171.6	173.2	1.0%	1.0%	0.9%
A.1 – People outside the labor force	73.7	66.5	64.7	20.7%	-9.7%	-2.9%
A.2 – Labor force population	96.3	105.1	108.5	-10.2%	9.1%	3.3%
A.2.1 – Unemployment	13.6	14.4	9.9	6.1%	6.0%	-31.4%
A.2.2 – Employment	82.7	90.7	98.7	-12.4%	9.6%	8.8%
Informal employment	30.7	36.4	39.3	-20.6%	18.8%	7.9%
Formal employment	52.1	54.2	59.4	-6.6%	4.2%	9.5%
Unemployment rate (A.2.1/A.2)	14.1%	13.7%	9.1%	2,2 p.p.	-0,4 p.p.	-4,6 p.p.
Employment rate (A.2.2/A)	48.7%	52.8%	57.0%	-7,4 p.p.	4,2 p.p.	4,1 p.p.
Participation rate (A.2/A)	56.7%	61.2%	62.7%	-7,1 p.p.	4,6 p.p.	1,4 p.p.

Source: IBGE. Prepared by: IFI.

Demand for labor: working population advances with an emphasis on acceleration on the formal side of the economy. The population employed in the informal segments of the economy (39.3 million people) grew 7.9% compared to the same period last year, while formal employment (59.4 million) rose 9.5%. The expansion in hiring is having a positive impact on the occupation level (the ratio between the working population and the working-age population). In July, it rose to 57%, 4.1 p.p. above the same period in 2021 and 1.0 p.p. above the period before the pandemic.

Labor supply: participation rate slowly moves back to pre-pandemic levels. The growth in the labor force drives the participation rate, a measure that tracks the entry and exit of working-age people from the labor market. The indicator, expressed as the ratio between the number of people in the labor force and the number of people of working age, reached 62.7% in the quarter ended in July, as shown in Chart 3 (1.4 p.p. above the level of 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 than the months before the pandemic (63.4%). If the participation rate remains at the same level as in February 2020, the unemployment rate in July of that year would be higher (10.1% of the labor force).

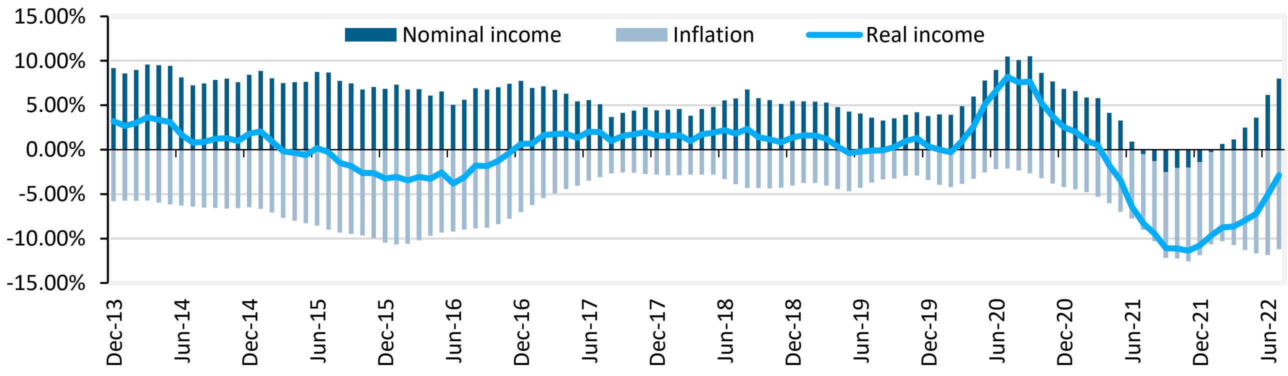
FIGURE 3. PARTICIPATION RATE AND OCCUPATION RATE



Source: IBGE. Prepared by: IFI.

The improvement in short-term inflation should continue to attenuate the fall in income. Also, according to data from PNAD Continuous, the average real income in the quarter ended in July dropped 2.9% compared to the same period a year earlier, although less sharply than in the previous quarter (5.1%). This movement followed the wage readjustments and the incipient tendency for inflation to improve (Figure 4).

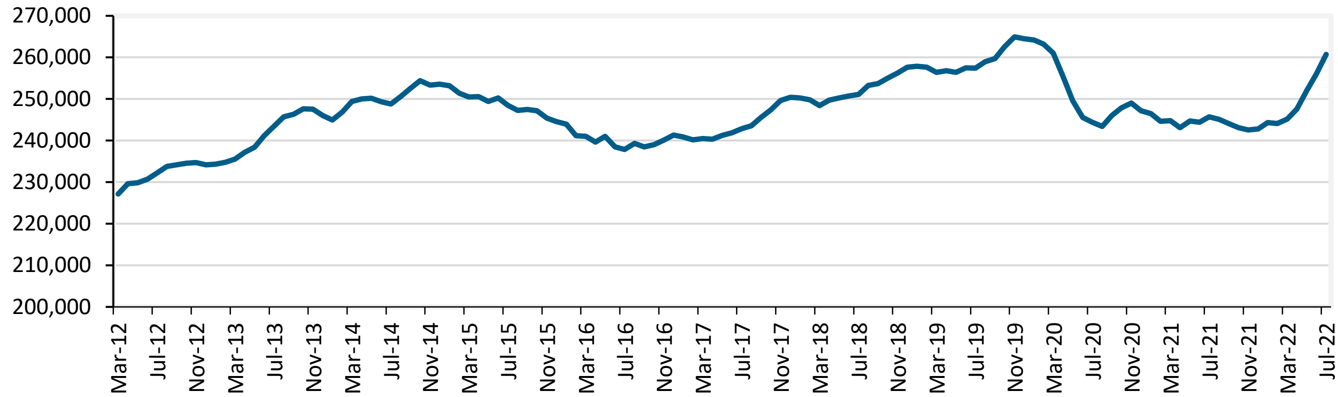
FIGURE 4. LABOR INCOME - ANNUAL GROWTH RATE



Source: IBGE. Prepared by: IFI.

Job creation contributes to the expansion of the overall wages. The overall wages, which combines the evolution of income with the occupied population, advanced 6.1% in real terms in the same comparison. Figure 5 shows a recovery in the income mass, favored by the expansion in hiring, although it remains below the pre-pandemic level.

FIGURE 5. OVERALL LABOR EARNINGS (R$ BI MAY-JULY 2022)



Source: IBGE. Prepared by: IFI.

1.3 Inflation and monetary policy

IPCA shows deflation for the second consecutive month. The August IPCA registered a -0.36% variation, bringing the accumulated figure for the last 12 months to 8.73% (compared to 10.07% in July). The recent data prompted a downward revision in the IPCA estimates, from 7.2% to 6.4% in 2022 and from 5.0% to 4.9% in 2023.

The fall in administered prices contributed to the deflation registered by the August IPCA. The change in administered prices, which account for around 25% of the total IPCA, went from -4.35% to -2.55% (Table 6). The accumulated change over 12 months, which stood at 11.73% in June, reached 1.46% in August, largely the result of the pass-through to consumers of recently approved tax measures (fuels, energy, and telecommunications) and the reduction in prices charged by Petrobras at its refineries with the drop in oil prices on the international market. The gasoline price, which makes up the administered group, registered a variation of -11.64% as a reflex of R$ 0.18/liter reduction at the refineries on August 16.

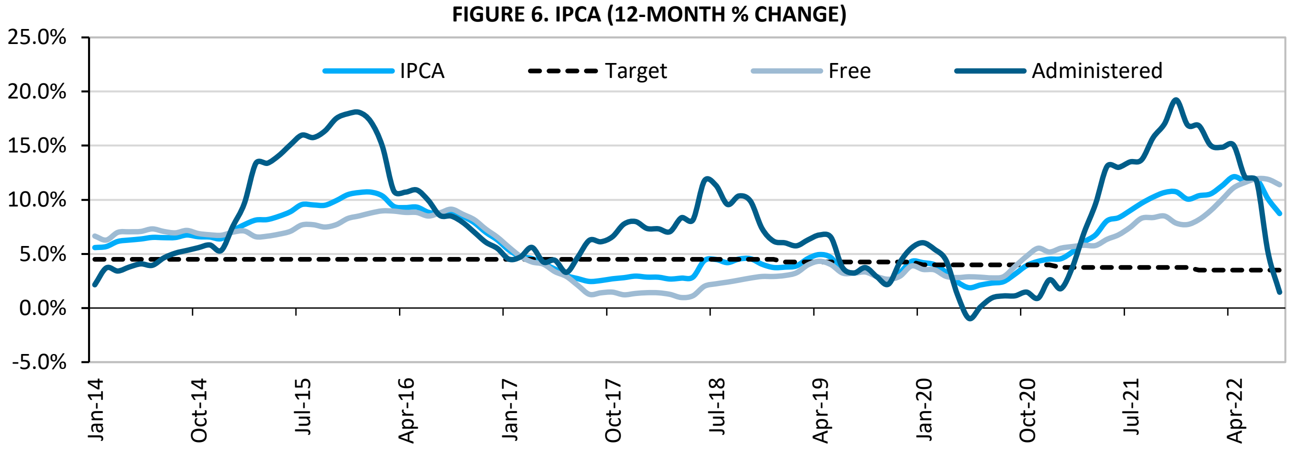
TABLE 6. IPCA: MONTH % CHANGE AND 12-MONTH

Consumer inflation	Month % change			12-month		
	Jun/22	Jul/22	Ago/22	Jun/22	Jul/22	Ago/22
IPCA	**0.67%**	**-0.68%**	**-0.36%**	**11.89%**	**10.07%**	**8.73%**
Administered prices *	**0.48%**	**-4.35%**	**-2.55%**	**11.73%**	**5.10%**	**1.46%**
Gasoline	-0.72%	-15.48%	-11.64%	26.92%	5.64%	-9.20%
Electricity	-1.07%	-5.78%	-1.27%	2.17%	-10.77%	-12.86%
Health insurance	2.99%	1.13%	1.13%	-2.18%	0.29%	1.52%
Pharmaceutical products	0.61%	0.57%	0.41%	13.81%	15.13%	15.28%
Market prices	**0.74%**	**0.65%**	**0.39%**	**11.94%**	**11.89%**	**11.39%**
Food-at-home	0.63%	1.47%	0.01%	16.69%	17.49%	15.62%
Services	0.90%	0.80%	0.28%	8.73%	8.87%	8.75%
Industrial goods	0.58%	-0.11%	0.82%	13.73%	12.83%	12.60%
Average of inflation cores	**0.89%**	**0.53%**	**0.66%**	**10.50%**	**10.43%**	**10.42%**

Source: IBGE and Central Bank. Prepared by: IFI.
** The administered prices are composed of more than 20 items. Gasoline, residential electricity, health insurance, and pharmaceutical products have the most significant weight.*

Signs of deceleration in free prices. Free prices, meanwhile, climbed 0.39%, decelerating compared to July (0.65%). In 12 months, the variation in these prices rose from 11.89% to 11.39%. The breakdown for free prices shows that the most significant pressure in August came from industrial prices (up 0.82% in the month and 12.60% in 12 months), while services (0.28% and 8.75%) and food-at-home (0.01% and 15.62%) slowed down in the month despite continuing at high levels.

FIGURE 6. IPCA (12-MONTH % CHANGE)



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

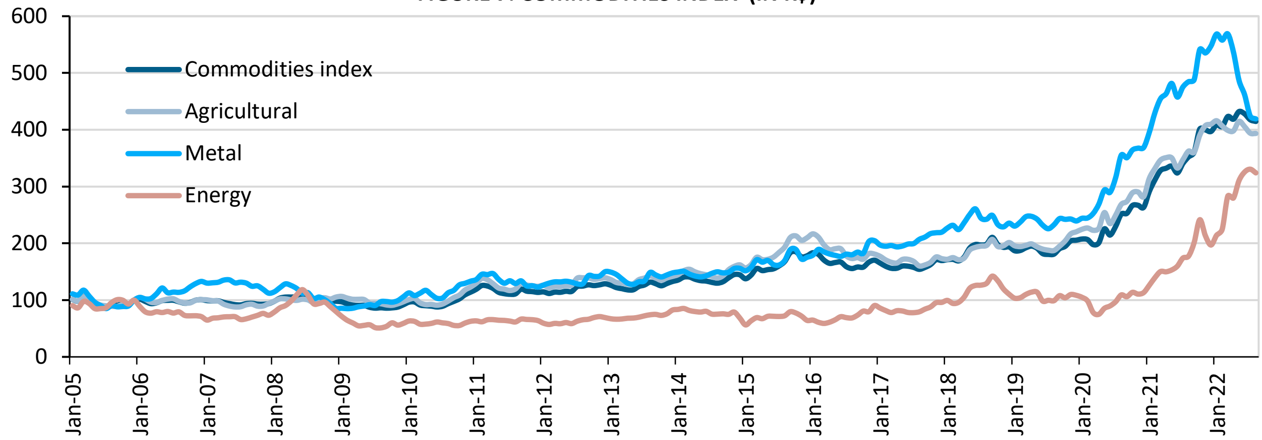
In any case, the cores still indicate the persistence of the inflationary process. Despite the short-term relief provided by tax cuts and the drop in oil prices, the behavior of the diffusion index and the cores still reveal pressures on consumer inflation and the persistence of the inflationary process. The IPCA's diffusion index, which indicates the share of IPCA items with positive variation in the month, rose from 62.6% in July to 65.3% in August. The average of the five cores monitored by the Central Bank (EX-0, EX-3, MS, DP, and P55) – measures that seek to remove the influence of more volatile items from total inflation – rose from 0.53% to 0.66%, remaining practically stable over the accumulated 12-month period ended in August (10.42%), above the interval compatible with compliance with the 2022 inflation target.

Commodity prices in reais show a downward trend in recent months. The Commodities Index – Brazil (IC-Br) calculated by the Central Bank dropped 0.72% between July and August, accumulating a high of 4.45% in 2022. In the last twelve months, the IC-Br increased by 17.7%, slowing down to July (22.6%). The three categories contributed negatively to the August aggregate result: agricultural (-0.12%), metal (-1.14%), and energy (-1.96%). This performance reflects the currency appreciation in the period and the reduction in international market prices resulting from weakening demand for raw materials. While supply constraints linked to the war in Ukraine support commodity prices, the challenging external environment (in a context of synchronized interest rate tightening in the United States and Europe and slowing the Chinese economy) is a restraining factor by reducing the demand for raw materials. Figure 7 below shows that the aggregate index (in local currency) has retreated in the last three months, although it remains high.

Commodity prices in local currency have shown a downward trend in recent months. The Commodities Index – Brazil (IC-Br) calculated by the Central Bank dropped 0.72% between July and August, accumulating a high of 4.45% in 2022. In the last twelve months, the IC-Br increased by 17.7%, slowing down to July (22.6%). The three categories contributed negatively to the August aggregate result: agricultural (-0.12%), metal (-1.14%), and energy (-1.96%). This performance reflects the currency appreciation in the period and the reduction in international market prices resulting from weakening demand for raw materials. While supply constraints linked to the war in Ukraine support commodity prices, the challenging external environment (in a context of synchronized interest rate tightening in the United States and Europe and slowing the Chinese economy) is a restraining factor by reducing the demand for raw materials. Figure

7 below shows that the aggregate index (in local currency) has retreated in the last three months, although it remains high.

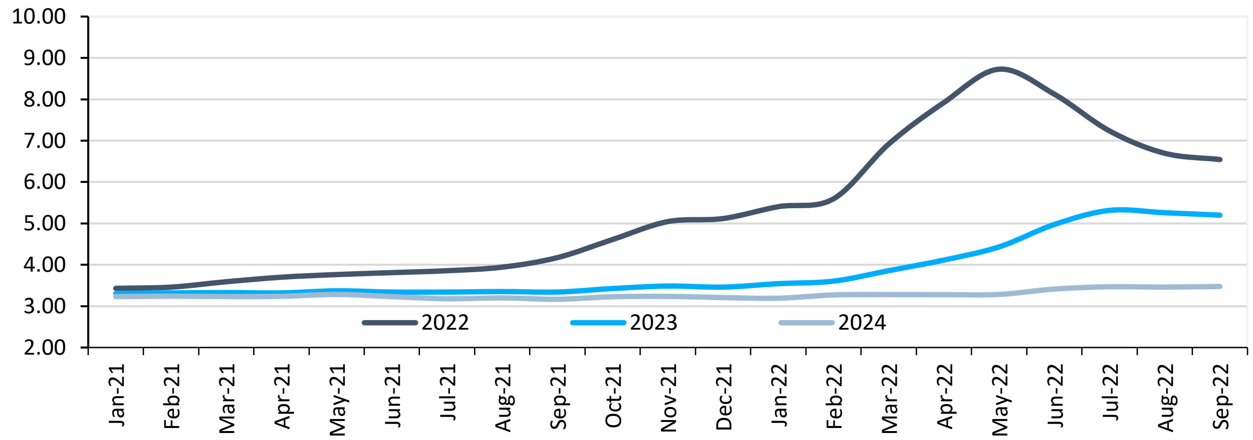
FIGURE 7. COMMODITIES INDEX (IN R$)



Source: Central Bank. Prepared by: IFI.

Inflation expectations ease in 2022 and 2023, remaining relatively stable (above the target) in 2024. The Central Bank's Focus survey shows a drop in the market's average projection for inflation in 2022 and 2023, currently at 6.5% and 5.2%. At the same time, the perspective for the IPCA in 2024 (the horizon in which the Central Bank intends to generate convergence of inflation expectations) is sustained at around 3.5%, just above the target set by the National Monetary Council (3.0%). The reduction in expectations for next year may be associated with the market's incorporation of the effect of the extension of the cut in federal taxes on fuel next year, while the uncertainties related to the fiscal path, to some extent, influence the projections for 2024.

FIGURE 8. FOCUS SURVEY - IPCA (2022, 2023 AND, 2024)

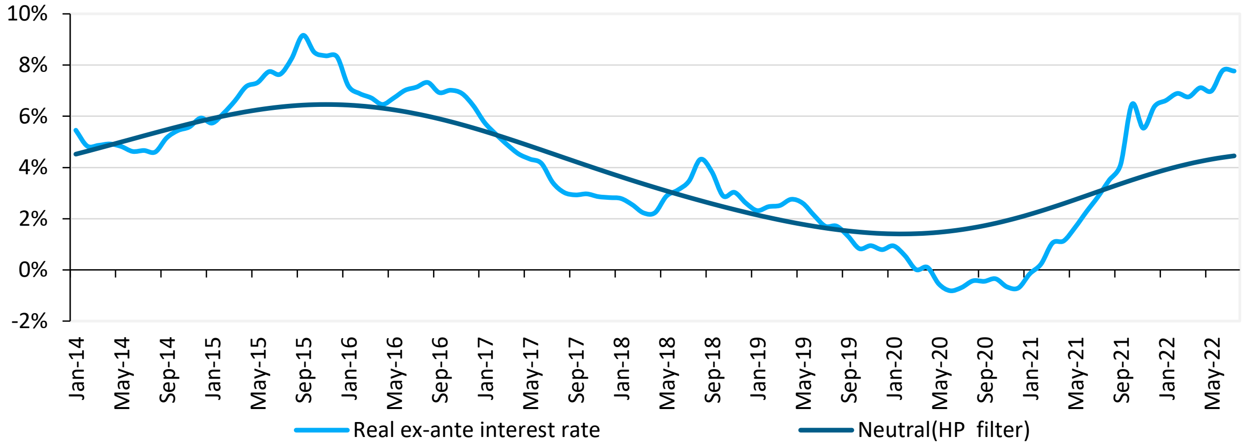


Source: Central Bank. Prepared by: IFI.

The Selic should end the year at 13.75%. In August, 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 will evaluate the need for a residual adjustment, of a smaller magnitude, at the next meeting (September 21) or if maintaining the base rate for a sufficiently long period will be enough to bring inflation around the target in the relevant horizon. The cycle of interest rate hikes, which started in March 2021 with the Selic rate starting at 2.0%, is nearing its end. We expect that Copom will end the cycle by maintaining the Selic rate at 13.75%, given the relatively stable behavior of inflation projections for 2024.

In real terms, the ex-ante interest rate based on the rate on pre-DI swap operations for a one-year term (13.7%), discounted from the projected inflation rate for the same period (5.5%), reached 7.8% in July (Figure 9). The position of the actual real interest rate above the estimated neutral real interest rate indicates that the monetary policy stance is contractionary. When the real interest rate is above the neutral interest rate, it contains economic activity and contributes to reducing inflation.

FIGURE 9. REAL EX-ANTE INTEREST RATE AND ESTIMATED NEUTRAL REAL INTEREST RATE



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

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, 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, it highlights a possible reversal of the increase in commodity prices in local currency and a sharper-than-projected slowdown in economic activity. In the reference scenario, Copom's inflation projections are 6.8% for 2022, 4.6% for 2023, and 2.7% for 2024.

Despite the recent relief in commodity prices, maintaining market expectations above the target for 2024 tends to limit the reduction of interest rates throughout 2023. Our base scenario contemplates the Selic rate reaching 10.50% by the end of 2023, although the presence of factors that bring risks to inflation in the medium term puts an upward bias on this forecast.

2. FISCAL SCENARIO

2.1 Primary revenues and transfers

Total federal primary revenue showed robust growth in August. According to information gathered by the IFI in the portal Siga Brasil of the Federal Senate and the Central Government Primary Balance Report (RTN) of the National Treasury Secretariat (STN), the central government's total primary revenue, which includes the federal government, the Central Bank and the INSS, totaled R$ 178.7 billion in August, growth of 8.9% to the same month in 2021 in real terms. In this comparison, revenues collected by the Federal Revenue Office (RFB) rose 6.5%, net social security (RGPS) revenues increased 5.3%, and revenues not managed by the RFB rose 24.7%.

Revenues collected by the RFB continued to be driven by taxes levied on income. In the group of revenues collected by the RFB, the collections of Income Tax (IR) and Social Contribution on Net Corporate Profits (CSLL) continued to show expansion in the year-on-year comparison (August 2022 versus August 2021), of 22.2% and 31.4%, in that order. The Tax on Industrialized Products (IPI) continued to shrink, dropping 31.1% in the same comparison due to the linear reductions of 35% promoted by the Executive Branch in the tax rates.

Also, in August, in the revenues not collected by the RFB group, the following are worthy of note: (i) dividends in the order of R$ 13.7 billion (an actual increase of 75.9% compared to August 2021), of which R$ 12.6 billion referring to dividends paid by Petrobras and R$ 1.1 billion of dividends transferred by Banco do Brasil; and (ii) revenues from the exploitation of natural resources, in the amount of R$ 7.4 billion (+30.5% compared to August 2021).

In the year to August 2022, primary revenue reached R$ 1,545 billion, an increase of 14.4% compared to 2021 in real terms (Table 7). In the first eight months of the year, the collection continued to reflect the dynamics of the main conditioning factors: economic activity, inflation, and commodity prices, although the last two factors already show signs of cooling.

The revenues not collected by the RFB performance in 2022 reflect collections from dividends, oil exploration, and concessions. In this comparison, collected revenues grew 9.7% above inflation, net collection for the RGPS rose 7.0%, and not collected revenues jumped 47.9%. The revenues not managed by the RFB growth in the year to August are driven by dividends and equity interests (R$ 65.6 billion), concessions and permits (R$ 41.9 billion), and revenues from the exploitation of natural resources (R$ 92.3 billion).

TABLE 7. CENTRAL GOVERNMENT REVENUES - 2020 TO 2022 - JAN. TO AUG. (CURRENT R$ BILLION, REAL % CHANGE AND % OF GDP)

	Jan-Aug/20			Jan-Aug/21			Jan-Aug/22		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total revenue	**891.2**	**-15.00%**	**18.50%**	**1,218.60**	**27.60%**	**21.40%**	**1,545.00**	**14.40%**	**24.20%**
Revenues Collected by RFB, except RGPS	*554.5*	*-15.50%*	*11.50%*	*768.3*	*29.40%*	*13.50%*	*933.8*	*9.70%*	*14.60%*
Fiscal incentives	*-0.1*	*-*	*0.00%*	*-0.1*	*-*	*0.00%*	*-0.1*	*-*	*0.00%*
RGPS	*233.1*	*-12.80%*	*4.80%*	*280.8*	*12.40%*	*4.90%*	*332.9*	*7.00%*	*5.20%*
Revenues not Collected by RFB	*103.8*	*-17.00%*	*2.20%*	*169.6*	*52.20%*	*3.00%*	*278.4*	*47.90%*	*4.40%*
Transfers	**171.7**	**-10.20%**	**3.60%**	**228.9**	**24.30%**	**4.00%**	**304.5**	**20.10%**	**4.80%**
Net revenue	**719.5**	**-16.10%**	**14.90%**	**989.8**	**28.40%**	**17.40%**	**1,240.50**	**13.10%**	**19.40%**
Total revenue without non-recurrent event*	**958.9**	**-5.70%**	**19.90%**	**1,173.20**	**14.20%**	**20.60%**	**1,472.80**	**13.20%**	**23.00%**
Net revenue without non-recurrent event *	**787.2**	**-4.70%**	**16.30%**	**944.3**	**12.00%**	**16.60%**	**1,168.30**	**11.60%**	**18.30%**
GDP (R$ billion)	**4,822.00**			**5,689.90**			**6,397.30**		

*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.*

Income tax collections and revenues associated with oil production boost transfers to subnational entities in 2022. Also, according to Table 7, transfers by revenue sharing totaled R$ 304.5 billion through August, an increase of 20.1% over 2021 in real terms. This result reflects the increase in Income Tax collection and collections from the production of oil and natural gas (Law 9,478/1997) and Law 14,337 of May 11, 2022, which provides for an additional transfer to the subnational entities regarding the pre-salt auctions in the amount of R$ 7.7 billion in 2022, through a special credit opened with resources from the excess of revenue from concessions and permissions.

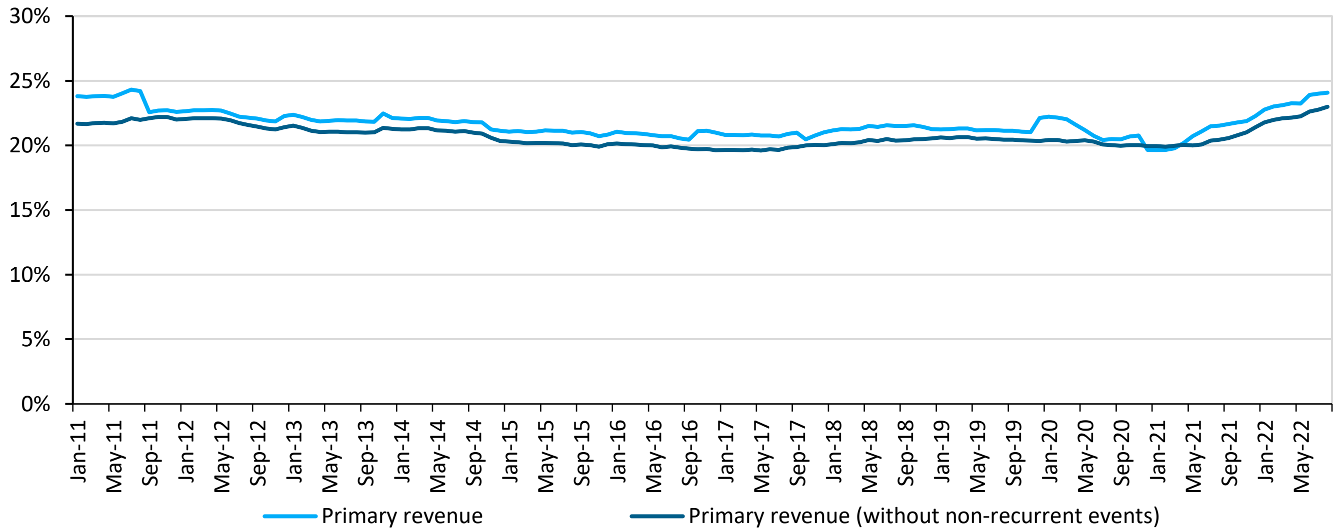
Considering a primary revenue of R$ 1,545.0 billion in 2022 through August and transfers by revenue sharing of R$ 304.5 billion, the central government's net primary revenue[3] totaled R$ 1,240.5 billion in the period, an increase of 13.1% compared to 2021.

Table 7 also presents total and net recurring revenues (free from the influence of atypical factors), which grew 13.2% and 11.6% (in real terms), in that order, from the year to August. The non-recurring events considered are described in the Special Study (EE) No. 17[4] and include collections from special fiscal recovery plans (Refis), the anticipation of dividends, operations with assets, and other atypical collections reported by the RFB.

Conventional and recurring primary revenues, measured as a proportion of GDP, continued to rise in August, although signs of deceleration are present. In a 12-month comparison, central government primary revenue totaled R$ 2,259.0 billion (24.1% of GDP) through August, while recurring primary revenue reached R$ 2,157.8 billion (23.0% of GDP). Figure 10 shows the evolution, since 2011, of these two series as a proportion of GDP. The trend is upward, although it is already possible to notice a cooling of the indicators at the margin.

By comparison, recurrent primary revenue went from 21.8% of GDP in January to 22.6% of GDP in June and recorded marginal increases in the following months, registering 22.8% and 23.0% of GDP in July and August, respectively.

FIGURE 10. CONVENTIONAL AND RECURRENT PRIMARY REVENUE (12 MONTHS - % OF GDP)



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

As mentioned in the previous section, there are signs of a slowdown in inflation and commodity prices, which should lead to a cooling down in tax collection in the coming months. It is worth mentioning that the increase in primary revenue as of the last quarter of 2020, as illustrated in Figure 10, occurred in line with the growth in commodity prices and inflation.

IFI's economic and fiscal scenarios highlight the impact of continued stimulus measures for 2023. In this edition of the RAF, the IFI has revised the central government's estimate for primary revenues in 2022 and 2023, considering the baseline macroeconomic scenario and an alternative scenario, which incorporates the effects of an eventual

[3] Net revenue corresponds to the volume of resources available to the Union after sharing revenues with states and municipalities.

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

continuation of fiscal stimulus measures, in principle, scheduled to end this year. The 2023 PLOA signaled the expectation of maintaining these stimuli, some already incorporated in the PLOA estimates and others evidenced in the presidential message forwarded along with the bill. Among the fiscal stimulus measures included in the PLOA, the continuity of federal tax exemptions on fuels stands out; among the actions signaled through the presidential message, we can mention the maintenance of the additional monthly benefit of R$ 200 per family in the Brazil Aid Program (PAB). The purpose of presenting two scenarios (base and alternative) is to explain the impacts of the measures on the macroeconomic and fiscal variables, even though the proposal will be discussed in Congress and may be modified.

Within the list of tax exemption extensions, the main measure that affects tax collection is the expected continuity of Cide, PIS/PASEP, and Cofins benefits on fuels in 2023. Table 8 presents the projections for total primary revenue, transfers by revenue, and net primary revenue under the two scenarios considered.

TABLE 8. REVENUE ESTIMATES - BASELINE AND ALTERNATIVE

	2022		2023	
	Baseline	Alternative	Baseline	Alternative
1. Total primary revenue	**2,359.77**	**2,359.83**	**2,351.93**	**2,282.83**
Revenues collected by the RFB	1,431.62	1,431.67	1,503.43	1,432.90
Net social security (RGPS)	541.56	541.58	561.46	562.89
Revenues not collected by the RFB	386.64	386.64	287.04	287.04
2. Transfers by revenue sharing	**466.09**	**466.1**	**475.43**	**453.12**
3. Net revenue [1-2]	**1,893.68**	**1,893.73**	**1,876.50**	**1,829.70**

Source: IFI.

In the baseline scenario, the projected drop in total primary revenue in 2023 is explained by the expected decline in revenues not collected by the RFB. In the baseline scenario, which incorporates the (permanent) 35% tax cut for IPI, the projected total primary revenue would be R$ 2,359.8 billion in 2022 and R$ 2,351.9 billion next year. The revenue forecast reduction for 2023, despite the 0.6% growth in GDP associated with this scenario, lies in the behavior of revenues not collected by the RFB, which would decline from R$ 386.6 billion in 2022 to R$ 287.0 billion in 2023. This reduction is concentrated in the collection of dividends, which would fall from R$ 95.0 billion in 2022 to R$ 38.0 billion in 2023, given that oil prices in the international market are expected to fall, which would affect Petrobras' profits and the distribution of dividends.

The continuity of tax exemptions, as evidenced in the PLOA 2023, affected the projection of tax collection for next year. The alternative scenario incorporates, besides the permanent reduction of the IPI tax already contemplated in the base scenario, the extension of tax exemptions and other tax incentives in the order of R$ 80.2 billion, as foreseen in the PLOA 2023[5]. The principal tax waiver consists of extending the Cide and PIS/Cofins exemptions on fuels and LGP. In the alternative scenario, the central government's total primary revenue would be R$ 2,282.8 billion in 2023, R$ 69.1 billion less than the total revenue projected in the baseline scenario. The impact on net revenues would be R$ 46.8 billion (R$ 1,829.7 billion in the alternative scenario against R$ 1,876.5 billion in the baseline scenario).

[5] Available at: https://www.gov.br/economia/pt-br/assuntos/planejamento-e-orcamento/orcamento/orcamentos-anuais/2023.

It is worth noting that, in the alternative scenario, the impact of the tax cuts would be partially offset by higher economic growth in 2023 (1.0%, versus 0.6% in the baseline scenario), even though the GDP price deflator would be 5.5% in the alternative scenario and 5.7% in the baseline scenario.

The IFI's previous expectation for total primary revenue in 2022, presented in August, was an amount of R$ 2,319.9 billion, i.e., R$ 39.9 billion higher than the current scenario. The increase in the September projection was mainly due to the expectation of a higher collection of dividends (R$ 95 billion, against R$ 55.4 billion projected in August).

By comparison, in August, the median forecast of the economists participating in the Monthly Report from Prisma Fiscal[6] of the Ministry of the Economy was a federal collection of R$ 2,220.1 billion in 2022. In the same report, the average of the projections of the podium (most accurate economists) is R$ 2,261.1 billion. On the other hand, the Executive Branch prediction in the Primary Revenue and Expenditure Evaluation Report for the 3rd Bimester of July 2022[7] is total primary revenue of R$ 2,226.1 billion this year.

2.2 Primary expenditures

Primary expenditure is projected to grow nominally by 12.9% in 2022. In the baseline scenario, the central government's primary spending should increase by R$ 208.4 billion, or 12.9% (Table 9). As a percentage of GDP, however, spending would remain at 18.6%, both in 2021 and 2022. The nominal expansion occurs in both mandatory and discretionary spending. Expenses to confront the Covid-19 pandemic should present a significant reduction to the previous year, even if partially offset by extra expenses in 2022 referring to extraordinary credits approved through Constitutional Amendment (EC) No. 123 of 2022, and the payment of a judgment to the municipality of São Paulo regarding Campo de Marte airport (R$ 23.9 billion). This year, the IFI projects expenses of around R$ 1,822.5 billion, of which R$ 1,665.7 billion is mandatory and R$ 156.9 billion is discretionary.

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

[7] Available at: https://www.tesourotransparente.gov.br/publicacoes/relatorio-de-avaliacao-de-receitas-e-despesas-primarias-rardp/2022/15.

TABLE 9. PRIMARY EXPENDITURE - BASELINE (R$ BILLION)

Breakdown	2021	2022	Change	
	Realized	IFI forecast	R$ billion	%
Primary expenditure	**1,614.2**	**1,822.5**	**208.4**	**12.9**
Mandatory	1,490.3	1,665.7	175.4	11.8
Social Security Benefits (RGPS)	709.6	793.6	84.1	11.8
Payroll	329.3	336.7	7.4	2.2
Salary allowance and unemployment insurance	45.9	64.1	18.2	39.6
BPC	67.7	80.1	12.5	18.4
Bolsa Família (Family Allowance)	25.8	97.0	71.3	276.7
Other mandatory	312.0	294.0	-18.0	-5.8
Discretionary (Executive)	123.9	156.9	33.0	26.6
Memo:				
Facing covid-19, EC 123 and Campo de Marte	*121.4*	*86.3*	*-35.1*	*-28.9*
Other	*1,492.7*	*1,736.2*	*243.5*	*16.3*

Source: Treasury (2021) and IFI (2022). Prepared by: IFI.

In August, the Union's primary expenditures should be R$ 190.4 billion, growing 37.4% above inflation in the same period last year. According to Siga Brasil, the central government's primary expenditure totaled R$ 190.4 billion in August, 37.4% compared to the same month in 2021. This growth can be attributed to non-recurring expenses and changes in the seasonal pattern of some expenditure items. Below is a description of the main items that influenced the federal expenditure in August.

- **Social security benefits:** R$ 71.7 billion represented an increase of 22.6% over August 2021, influenced by the payment of R$ 12.3 billion in judgments and court-ordered debts. In the absence of these payments, RGPS expenses would have grown 1.6%, in real terms, in the comparison between August and the same month in 2021;
- **Payroll:** R$ 33.2 billion in expenses in August represented an increase of 22.5% compared to the same month last year. There was, however, an R$ 8.1 billion expense related to payment of court-ordered debts, which, stripped out of the R$ 33.2 billion, would cause payroll expenses to drop 7.3% in August compared to August 2021, in real terms;
- **Extraordinary credits (except PAC):** expenditures of R$ 7.1 billion, of which R$ 4.3 billion refer to income transfers in the scope of the Brazil Aid. In the IFI scenario, these transfers should remain at the level of R$ 4.6 billion per month between September and December due to the payment of additional aid in the amount of R$ 200 per family, regulated by EC No. 123, of July 14, 2022;
- **Judgments and court-ordered debts:** payments of R$ 6.5 billion in August against R$ 220.4 million in August 2021. It is worth saying that last year R$ 16.4 billion were paid in June;
- **Electoral campaign financing:** expenditure of R$ 5.0 billion with no counterpart in August 2021; and
- **Discretionary expenses:** R$ 32.5 billion (an increase of 147.9%) influenced by the Federal Government's payment of R$ 23.9 billion to the City of São Paulo as indemnity for the use of the Campo de Marte airport area. In the absence of the R$ 23.9 billion payment, discretionary spending would have fallen 34.7% compared to August 2021.

The events described above totaled expenses of R$ 60.1 billion (R$ 12.3 billion in RGPS court-ordered debts, R$ 8.1 billion in payroll expenses, R$ 4.3 billion in extraordinary credits under the Brazil Aid, R$ 6.5 billion in judgments and court-ordered debts, R$ 5.0 billion in the electoral campaign expenditures and R$ 23.9 billion in the Campo de Marte payment) in August with no counterpart in the same month of 2021.

In the year, total primary expenditure reached R$ 1,219.2 billion in 2022, 2.6%, in real terms, above the incurred between January and August of last year (Table 10), reflecting: the expenses with salary allowance and unemployment benefit (a 32.4% increase, mainly due to the change in the payment schedule of the salary allowance), the Union's supplement to the Fundeb, which is in a transition period with a gradual increase in the amount to be transferred to the fund (a rise of 50, 4%), the mandatory expenses with flow control, influenced by the expenses with the Bolsa Família (Family Allowance) and Auxílio Brasil (Brazil Aid) programs (43.3%), and the discretionary expenses, which grew due to an atypical event in the amount of R$23.9 billion with no counterpart in the first months of the previous year.

TABLE 10. CENTRAL GOVERNMENT PRIMARY EXPENDITURE – 2020 TO 2022 – JAN. TO AUG. (CURRENT R$ BILLION, REAL % CHANGE AND % OF GDP)

Breakdown	Jan-Aug/20			Jan-Aug/21			Jan-Aug/22		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total expenditure	**1,320.8**	**45.1%**	**27.4%**	**1,071.9**	**-24.4%**	**18.8%**	**1,219.2**	**2.6%**	**19.1%**
Social Security Benefits (RGPS)	*458.6*	*14.0%*	*9.5%*	*491.3*	*-0.2%*	*8.6%*	*548.9*	*0.8%*	*8.6%*
Payroll (working and retired employees)	*208.9*	*-0.2%*	*4.3%*	*215.4*	*-3.9%*	*3.8%*	*219.8*	*-7.9%*	*3.4%*
Salary allowance and unemployment insurance	*43.5*	*13.1%*	*0.9%*	*34.2*	*-26.1%*	*0.6%*	*51.0*	*34.2%*	*0.8%*
Continuous Cash Benefit (BPC)	*41.8*	*2.7%*	*0.9%*	*45.3*	*1.0%*	*0.8%*	*52.2*	*4.0%*	*0.8%*
Extraordinary Credits (except PAC)	*293.6*	*9884.3%*	*6.1%*	*82.7*	*-74.0%*	*1.5%*	*21.8*	*-76.0%*	*0.3%*
Compensation to RGPS for Exemption of Payroll Taxes	*6.8*	*-11.6%*	*0.1%*	*5.2*	*-28.5%*	*0.1%*	*3.1*	*-46.2%*	*0.0%*
Fundeb	*11.3*	*1.3%*	*0.2%*	*13.0*	*7.0%*	*0.2%*	*21.6*	*50.4%*	*0.3%*
Court Rulings and Court-Ordered Debts (current and capital expenditure)	*21.8*	*46.2%*	*0.5%*	*17.7*	*-24.9%*	*0.3%*	*15.7*	*-20.0%*	*0.2%*
Subsidies, Grants, and Proagro	*23.8*	*129.4%*	*0.5%*	*5.3*	*-79.3%*	*0.1%*	*13.2*	*126.2%*	*0.2%*
Mandatory expenditure	**1,256.2**	**48.7%**	**26.1%**	**1,011.1**	**-25.0%**	**17.8%**	**1,112.2**	**-0.7%**	**17.4%**
Mandatory spending with flow control	***80.6***	***-12.2%***	***1.7%***	***90.3***	***4.6%***	***1.6%***	***143.5***	***43.3%***	***2.2%***
Discretionary	**64.6**	**-0.6%**	**1.3%**	**60.8**	**-12.7%**	**1.1%**	**107.0**	**58.6%**	**1.7%**
Total expenditure without non-recurrent events*	**908.5**	**-0.2%**	**18.8%**	**943.6**	**-3.2%**	**16.6%**	**1,126.4**	**7.7%**	**17.6%**
GDP (R$ billion)	**4,822.0**			**5,689.9**			**6,397.3**		

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

Social security benefits should show relative stability to the previous year. The IFI estimates that spending on social security benefits, including judgments and court-ordered debts, should end 2022 at 8.1% of GDP (R$ 793.6 billion). This figure incorporates data from January to August and the IFI's projection for the following months. According to data extracted by the IFI in Siga Brasil, the social security expense in the first eight months of the year grew 11.7% to the same period in 2021. In real terms, corrected by the IPCA at August 2022 prices, this percentage was 0.8%. This variation considers eventual expenses related to judicial sentences or annual allowances (13th salary). In the case of expenditures with the General Regime of Social Security (RGPS), the first months are good predictors of the rest of the fiscal year. Thus, we opted to maintain the projection for spending on social security benefits this year at R$793.6 billion, an increase of R$ 84.1 billion, or 11.8%, relative to 2021 (Table 9). As a percentage of GDP, there is a slight decrease from 8.2% to 8.1% of GDP over the period.

Finally, the central government's recurrent primary expenditure, calculated by the IFI based on the methodology published in EE No. 17 mentioned above, totaled R$ 1,126.4 billion in accumulated 2022 through August, an increase of 7.7% over 2021 (Table 10). The calculation considers non-recurring: the covid-19 expenses, the pre-sal onerous assignment, the Sovereign Fund of Brazil, the anticipations in the payment of the salary allowance and the 13th salary of the RGPS, and other expenses, such as the payment for the right to use Campo de Marte.

In the eight months accumulated in 2022, the non-recurring events in expenses totaled R$ 92.8 billion, of which R$ 18.7 billion were spent on fighting the pandemic, R$ 50.2 billion on anticipation of the annual allowance (13th salary) to retirees and pensioners of the INSS, and R$ 23.9 billion referring to Campo de Marte.

In the 12 months ending in August, primary expenditures reached R$ 1,761.4 billion (18.8% of GDP), a reduction of 6.6% compared to the same month in 2021. As presented for revenues, the IFI calculated two scenarios for expenditure in 2022 and 2023, considering the possible impacts if fiscal stimulus measures are extended into next year, as evidenced in the PLOA or the presidential message.

The EC 123 of 2022 established a series of social benefits, highlighting an additional R$ 200 per month per family to be granted until December 2022. The benefits were made operational through extraordinary credits not to affect the spending ceiling. Thus, in August, for example, the expenses with the Brazil Aid program were about R$ 12 billion, of which R$ 4.3 billion refer to the temporary additional. The lack of definition regarding the continuity of this measure and the way it will be allocated in next year's budget increases the uncertainties on the fiscal front.

The prospect of maintaining the Brazil Aid at R$ 600 next year will demand an effort to accommodate it in the budget. Although the 2023 PLOA was sent to Congress considering a hypothesis of spending R$ 105.7 billion on the PAB, which is equivalent to an average monthly benefit of R$ 405 per month for about 21.6 million families, the Presidential Message sent with the 2023 PLOA indicates the government's intention to expand the benefits for next year with an additional R$ 200 per month per family. According to the message, the federal government "recognizes the relevance of this public policy and the importance of continuing this increase for the families served by the Program" (Presidential Message: PLOA 2023, p. 36)[8].

Also, according to the message, the President informs that the "Executive Branch will make efforts to find legal solutions and budgetary measures that allow the maintenance of this value in the year 2023, through dialogue with the National Congress to meet this priority". (Presidential Message: PLOA 2023, p. 36).

Thus, even though the PLOA has not contemplated extending the additional R$ 200 of the PAB, it is necessary to analyze the impacts, paths, and fiscal risks associated with a possible extension of the additional benefit.

It is worth pointing out that EC No. 123 authorizes the payment of an additional R$ 200 for PAB beneficiaries until December. The maintenance of the additional benefit would demand adjustments in the budget and eventually in the fiscal rules, either to make the extra expense exceptional to the ceiling rule or to accommodate it to the existing regime. In other words, if the option is to keep the Brazil Aid at R$ 600 next year, the government will need, at the appropriate time, to disclose how this payment would be made, complying with the constitutional rule of the spending ceiling.

A particular scenario has incorporated an additional PAB of R$ 200 per family per month next year. Table 11 presents the total primary IFI expenditure projections for 2022 and 2023 in the baseline and alternative scenarios. Because there is no legal provision for the payment of R$ 600 under Brazil Aid next year, the projections do not incorporate this expenditure. Below, a simulation will be presented and the fiscal risk associated with the R$ 600 Aid, whose expense was incorporated into a modified alternative scenario.

Scenarios for primary expenditure include the effects of the Provisional Presidential Decree No. 1,135 of 2022. The expenditure projections in the base and alternative scenarios incorporate the postponement of the transfers to the culture and events sectors foreseen in laws created to mitigate the effects of the pandemic on these activities (Law No. 14,148, 2021, Law No. 14,399, 2022, and Supplementary Law No. 195, 2022), according to Provisional Presidential

[8] Available at: https://www.gov.br/economia/pt-br/assuntos/planejamento-e-orcamento/orcamento/orcamentos-anuais/2023/ploa/Mensagem_Presidencial_2023.pdf.

Decree 1,135, of 2022. The matter provides for the payments to these sectors in the situation where there are budgetary and financial availabilities in the Union's budget.

TABLE 11. CENTRAL GOVERNMENT PRIMARY EXPENDITURE 2022 AND 2023 FORECASTS (R$ BILLION)

Breakdown	2022		2023	
	Baseline	Alternative	Baseline	Alternative
Total expenditure	**1,822.5**	**1,822.5**	**1,869.5**	**1,869.4**
Social Security Benefits (RGPS)	*793.6*	*793.6*	*862.2*	*862.2*
Payroll (working and retired employees)	*336.7*	*336.7*	*372.4*	*372.4*
Salary allowance and unemployment insurance	*64.1*	*64.1*	*68.6*	*68.7*
Continuous Cash Benefit (BPC)	*80.1*	*80.1*	*89.4*	*89.4*
Extraordinary Credits (except PAC)	*53.4*	*53.4*	*2.0*	*2.0*
Fundeb	*33.4*	*33.4*	*40.0*	*40.0*
Court Rulings and Court-Ordered Debts (current and capital expenditure)	*19.2*	*19.2*	*24.7*	*24.7*
Subsidies, Grants, and Proagro	*21.5*	*21.5*	*22.1*	*22.1*
Mandatory	**1,665.7**	**1,665.7**	**1,753.7**	**1,753.7**
Mandatory spending with flow control	***222.6***	***222.6***	***239.0***	***239.0***
Discretionary	**156.9**	**156.9**	**115.8**	**115.7**

Source: STN. Prepared by: IFI.

The IPCA projection influences the calculation of the Federal Government's spending ceiling. The difference between the baseline and alternative primary expenses scenarios, presented in Table 12, lies in the projections considered for the IPCA in 2022, which defines the expenditure ceiling for the year. As illustrated in the Macroeconomic Context section, the IFI's projection for the IPCA of 2022 is 6.4% in both scenarios (base and alternative). The difference is only in the third decimal place. A lower value for the IPCA results in a lower ceiling for total primary expenditure. The projection for the IPCA of 2022 has been revised downwards in recent weeks, mainly due to the extension of the exemption of federal taxes (PIS/PASEP, Cide, and Cofins) on fuel and LPG foreseen in the PLOA 2023.

Table 12 presents values for a variation of the alternative scenario, the modified alternative scenario, to incorporate the expenditure of the Brazil Aid in the amount of R$ 600 for 21.6 million families. The IFI estimates the impact of this measure to be R$ 51.8 billion on primary expenditure in 2023. The table simulates the situation in which Brazil Aid is accommodated in the budget by cutting discretionary spending.

TABLE 12. ALTERNATIVE SCENARIO ADJUSTMENT TO INCORPORATE THE BRAZIL AID OF R$ 600 FROM 2023 ON

Riscal risks (2023)	R$ billion		% of PIB	
	Baseline	Alternative adjusted	Baseline	Alternative adjusted
Brazil Aid at R$ 600 for 21.6 million families	-	51.8		0.5
Discretionary, in case the increase is subject to the ceiling	115.7	63.9	1.1	0.6
Primary expenditure, in case the increase is extra-ceiling	1,869.4	1,921.3	17.9	18.4

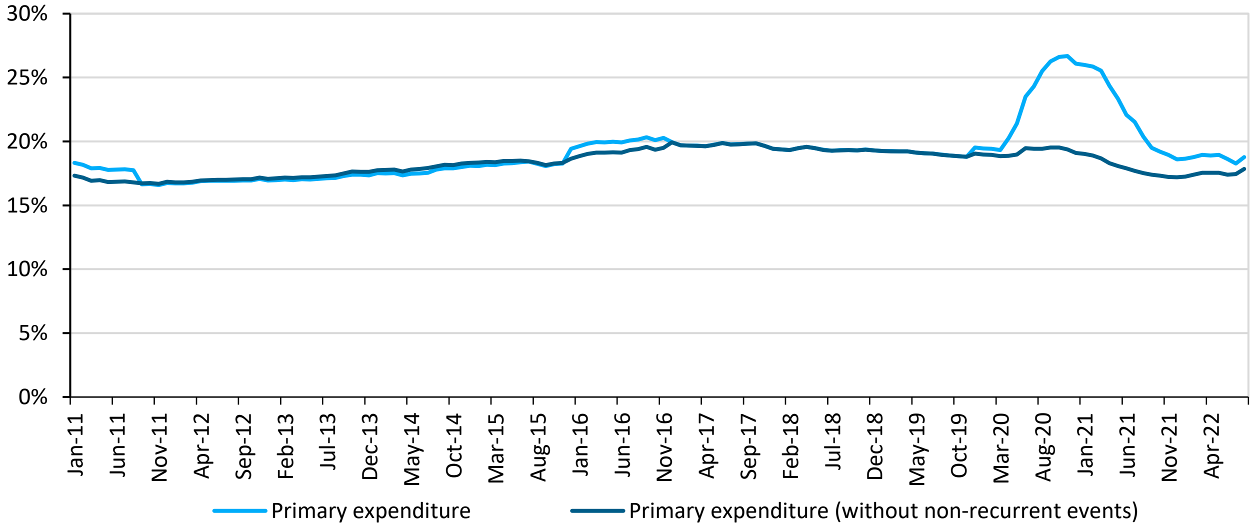
Source: IFI.

An additional R$ 200 per month for 21.6 million families is equivalent to an expenditure of 0.5% of GDP in 2023. According to Table 12, the incorporation of the Brazil Aid expense of R$ 600 for 21.6 million families benefited in a scenario in which the expenses are executed outside the ceiling rule in 2023 would raise the central government's total primary expenditure from R$ 1,869.4 billion to R$ 1,921.3 billion. If the benefit is conducted within the ceiling rule, an eventual compression of discretionary expenses to accommodate the R$ 51.8 billion in the expenditure ceiling will cause these expenses to fall from R$ 115.7 billion (1.1% of GDP) to R$ 63.9 billion (0.6% of GDP), a reduction equivalent to 0.5 p.p. of GDP. The discretionary spending of R$ 115.7 billion represents a moderate risk of non-compliance with the spending ceiling, while the volume of R$ 63.9 billion raises this risk, given the high possibility of paralyzing the functioning of the public machine.

A simulation indicates the difficulty towards Brazil Aid of R$ 600 feasible with these expenses within the ceiling. A scenario like the one presented in the paragraph above is not reasonable because of the minimum amount of discretionary spending needed to run the public machine. According to the IFI, in 2022, this minimum discretionary spending would be around R$ 117 billion. In 2023, this amount would rise to R$ 122 billion. The exercise shows the lack of room in the federal spending ceiling for executing the Brazil Aid expense of R$ 600 and the difficulties imposed on the government to accommodate this expense in the budget.

Despite the increase in August, primary expenditure measured as a proportion of GDP remains relatively under control. To close this subsection, we present the 12-month trajectory of the conventional and recurring primary expense, calculated by the IFI according to the methodology presented in EE no.17. Figure 11 contains these two series measured as a proportion of GDP. Total primary expenditure reached 18.8% of GDP in August, down from 18.3% in July and 18.6% in June. Non-recurring spending rose from 17.4% of GDP in June and July to 17.9% in August. The two curves indicate that primary spending remains relatively under control.

FIGURE 11. TOTAL PRIMARY EXPENDITURE (WITH AND WITHOUT NON-RECURRING EVENTS) - % OF GDP



Source: STN. Prepared by: IFI.

Constitutional Amendment No. 124 of July 14, 2022, established that federal law would institute the national wage floors for nurses, nursing technicians and assistants, and midwives[9]. The following month, Law 14,434, August 4, 2022, established R$ 4,750 for nurses, R$ 3,325 for nursing technicians, and R$ 2,375 for nursing assistants and midwives[10].

Legal uncertainty about the floor is an object of a lawsuit in the STF. Until this report's conclusion, the court's ministers had not yet concluded the vote on the suspension of the measure. In addition, the design of eventual support measures from the Union to subnational entities and the private sector (readjustment of the SUS tariff, debts compensation, and payroll tax exemption) is unclear. Therefore, for the time being, we have decided not to incorporate the impact into our scenarios. The IFI will continue to follow the issue.

The nursing floor would have an annual impact of R$ 5.5 billion in the public sector, concentrated in the subnational entities (Table 13). The value represents how much more would need to be spent, assuming that all jobs are maintained. The municipal sphere concentrates the most significant impact (R$ 3.9 billion), in part because this is where the most important number of public sector professionals benefited by the measure are located. The slightest impact is in the federal sphere (R$ 26.9 million). As suggested above, despite the emphasis on the subnational entities, the ongoing debate among federal authorities indicates that the Union would adopt measures to support this new expense, ensuring that the other entities meet the profession's salary floor.

TABLE 13. ANNUAL IMPACT ESTIMATE OF THE NURSING WAGE FLOOR ON EXPENSES

Sector	Annual Impact (R$ million)
Public Sector	5,508.3
Federal	26.9
State Sphere	1,499.4
Municipal sphere	3,929.3
Public enterprises (three spheres)	52.6
Business private sector	5,488.4
Non-profit private sector	6,382.9
Total	**17,379.6**

Source: IFI, from RAIS 2020 data.

Union measures to support subnational entities and the private sector would cost R$ 17.4 billion annually. Of this total, R$ 5.4 billion would correspond to aid to states and municipalities, and R$ 11.9 billion would assist the private business (R$ 5.9 billion) and non-profit (R$ 6.4 billion) sectors.

2.3 The central government and the consolidated public sector balance

The data collected by the IFI on the Siga Brasil portal showed a primary deficit of R$ 51.8 billion for the central government in August, compared to a R$ 9.1 billion deficit in the same month of 2021. Disregarding the R$ 60.1 billion expenses presented in the previous subsection, which had no counterpart in 2021, there would have been a primary surplus of R$ 8.3 billion in August.

[9] Available at: https://www.planalto.gov.br/ccivil_03/Constituicao/Emendas/Emc/emc124.htm.

[10] Available at: https://www.planalto.gov.br/ccivil_03/_Ato2019-2022/2022/Lei/L14434.htm.

Expenses with no counterpart in 2021 affected the Union's primary result in August. In the accumulated 2022, the central government recorded a primary surplus of R$ 21.3 billion, below the R$ 73.1 billion surpluses accumulated until July. Given the spending ceiling, the accumulated primary surplus in 2022 continues to reflect the increase in revenues and the relative control of primary spending.

The baseline and alternative scenarios produce different figures for the central government's primary balance. In the 12 months through August, the central government had a primary surplus of R$ 68.4 billion (0.7% of GDP). For this year, the IFI projects a surplus of R$ 71.2 billion in both scenarios (base and alternative). For 2023, however, the estimate range from a slight surplus of R$ 7.0 billion to a deficit of around R$ 91.6 billion. The high uncertainty regarding the following year's fiscal scenario appears in the form of three fiscal scenarios: (i) baseline respecting the validity of the emergency measures that were adopted this year, (ii) alternative, in which the fiscal stimulus measures adopted this year are extended to the following, respecting the current spending ceiling, i.e., the extension of the additional PAB benefit is subject to the spending ceiling; and (iii) alternative with the extension of the additional PAB benefit not subject to the spending ceiling. Thus, the projections of primary revenues and expenses presented in this subsection will imply different figures for the primary balance this year and next. Table 14 displays these values, considering the three scenarios described above.

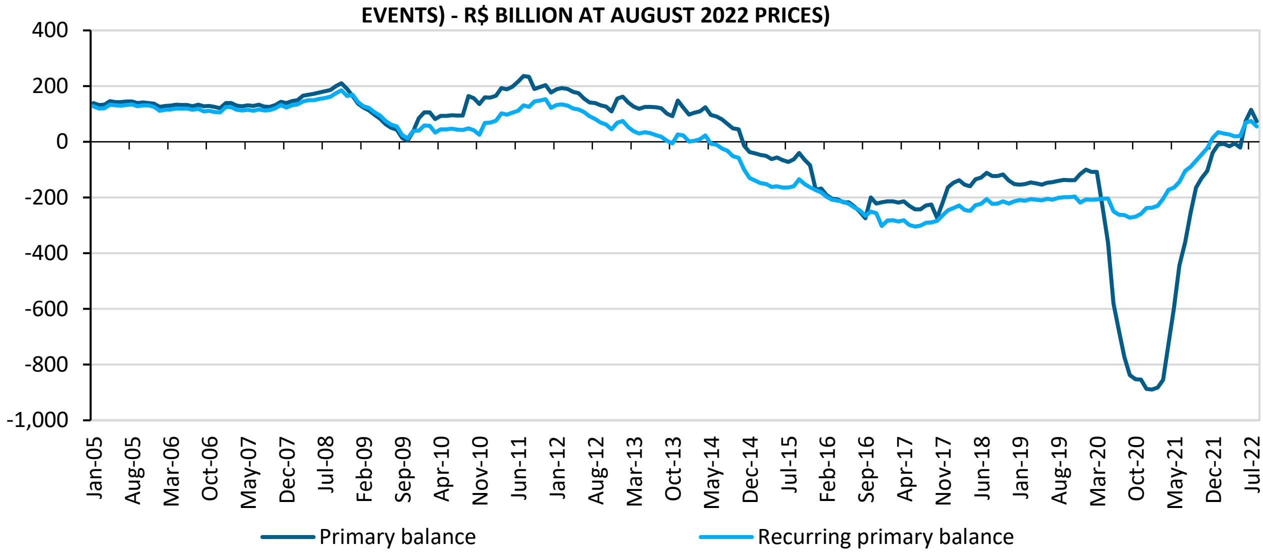
TABLE 14. CENTRAL GOVERNMENT PRIMARY BALANCE 2022 AND 2023 ESTIMATES (R$ BILLION)

	2022		2023		
	Baseline	Alternative	Baseline	Alternative	Alternative modified
Net revenue	1,893.7	1,893.7	1,876.5	1,829.7	1,829.7
Primary expenditure	1,822.5	1,822.5	1,869.5	1,869.4	1,921.3
Primary balance	71.2	71.2	7.0	-39.7	-91.6

Source: IFI.

Exemptions foreseen in the 2023 PLOA and the payment of the R$ 600 Brazil Aid may raise the Federal Government's primary deficit to R$ 91.6 billion in 2023. From Table 14: (i) in 2022, the primary revenue forecast's upward revision raised our expectation for the central government primary surplus to R$ 71.2 billion (from R$ 27.0 billion projected in August); (ii) for 2023, in the baseline, the IFI's projection for the federal primary surplus is R$ 7.0 billion, while the projection in the alternative scenario is for a primary deficit of R$ 39.7 billion due to the tax cuts foreseen in the PLOA 2023, but with no impact on the expenditure side, since the additional R$ 200 per family per month related to the PAB would be compensated by a reduction in other expenditures to accommodate this expenditure to the ceiling rule; and (iii) in the alternative scenario in which the additional benefit of the PAB is executed outside of the ceiling, the primary deficit projected for 2023 increases to R$ 91.6 billion.

FIGURE 12. CENTRAL GOVERNMENT'S PRIMARY BALANCE (WITH AND WITHOUT NON-RECURRING EVENTS) - R$ BILLION AT AUGUST 2022 PRICES)



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

Figure 12 presents the 12-month trajectory of the central government's conventional (observed) and recurring primary balances at August 2022 prices. While the traditional balance was a surplus of R$ 73.3 billion in August, the recurring balance was positive at R$ 54.6 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 grow at an accelerated pace.

2023 presents an increase in fiscal risk, both on the revenue and expenditure sides. 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. On the expenditure side, the possible extension of the additional benefit of the PAB in the average monthly amount of R$ 600 per family also represents a risk, given the lack of space in the federal spending ceiling for executing this expense. The way this expenditure would be accommodated may influence the credibility of the country's fiscal regime. The IFI will continue to monitor these risks promptly.

Data from the Central Bank indicate robust primary surpluses for the federal government and sub-national entities from 2022 through July. We will now analyze the data made available by the Central Bank, updated up to July 2022, regarding the primary and nominal balances of the consolidated public sector calculated based on the below-the-line methodology[11]. In the seven months of 2022, the public sector, including the central government, regional governments, and state-owned companies, had a primary surplus of R$ 150.3 billion against a deficit of R$ 15.5 billion in the same period of 2021. The central government calculated a R$ 73.7 billion surplus in 2022 until July, while the states and municipalities accumulated a positive result of R$ 72.3 billion and state companies another R$ 4.3 billion.

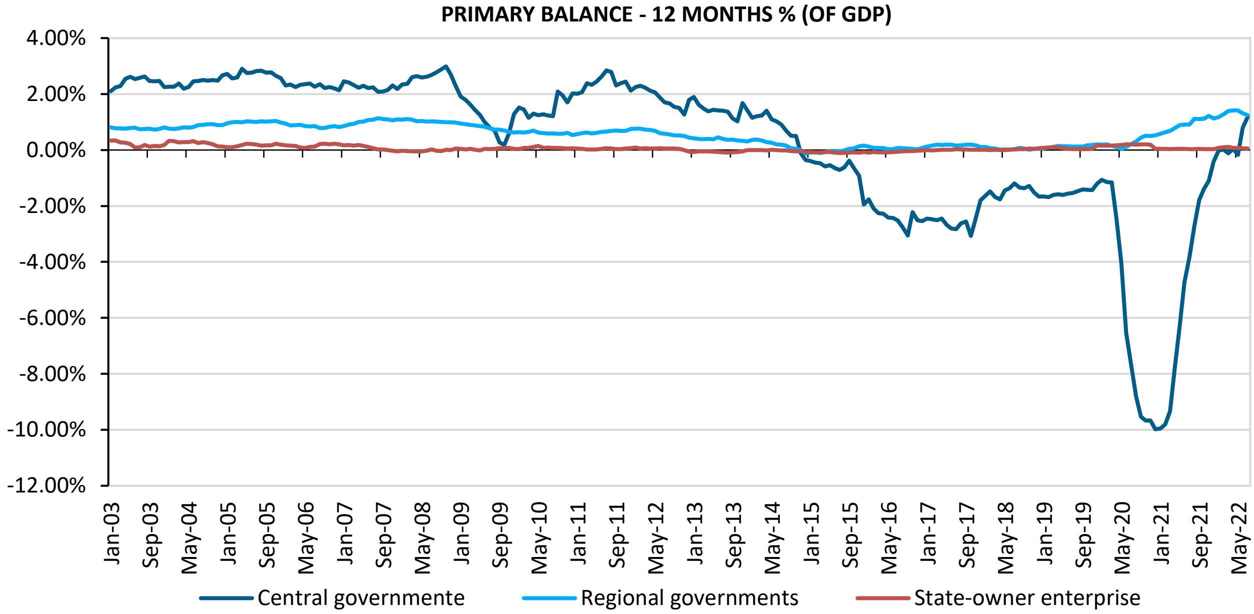
In the 12 months to July, the public sector had a primary surplus of 230.6 billion (2.5% of GDP), according to the Central Bank. Of this amount, the central government (federal government, Central Bank, and INSS) was responsible for a surplus of R$ 109.9 billion (1.2% of GDP), while the regional governments (states and municipalities) and state companies had surpluses of R$ 115.6 billion (1.2% of GDP) and R$ 5.1 billion (0.1% of GDP), respectively. This information is presented in Figure 13.

[11] For a more detailed explanation, see the Fiscal Statistics Manual of the Central Government Primary Balance Report: https://bit.ly/3pjxgEv.

The 12-month accumulated primary surplus of states and municipalities began to fall in June. Also, concerning Figure 13, it is worth noting that the regional governments' primary surplus fell from 1.4% of GDP in May to 1.3% of GDP in June and 1.2% of GDP in July. In the second semester, the innovations brought by Supplementary Law (LC) No. 194 of June 23, 2022, such as the classification of telecommunications, electricity, fuels, and public transportation as essential goods and services, will reduce the collection of subnational entities, thus affecting the trajectory of the primary surplus.

ICMS tax collection cooled off in July. As an illustration, according to Confaz, the ICMS collection of the 26 states and the Federal District fell 16.9% in real terms in July compared to the same month in 2021. Until June, the ICMS collections registered an expansion in the year-on-year comparison. Until July, the tax revenues increased by 1.2%, compared to 4.5% until June and 4.8% until May.

FIGURE 13. CENTRAL GOVERNMENT, REGIONAL GOVERNMENTS, AND STATE-OWNED ENTERPRISE'S PRIMARY BALANCE - 12 MONTHS % (OF GDP)



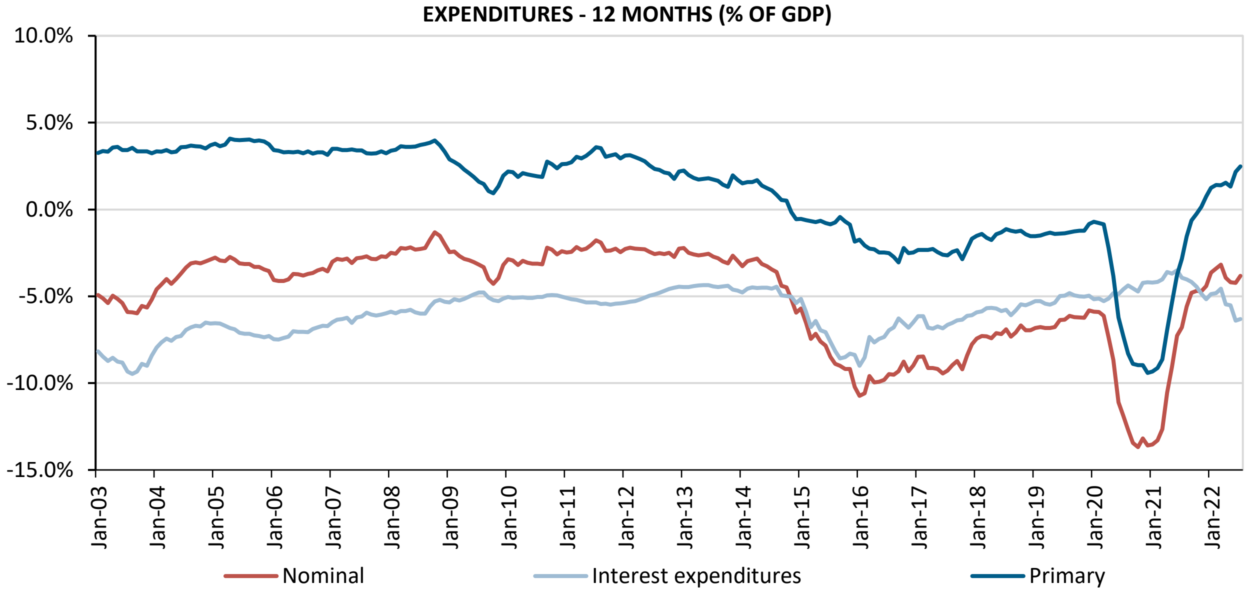
Source: Central Bank. Prepared by: IFI.

Considering the public sector nominal result, which includes the primary balance and the payment of interest on the public debt, in the 12 months ending in July, there was a deficit of R$ 355.9 billion (3.8% of the GDP). Figure 14 presents this information. The deficit composition was as follows: central government nominal deficit of 4.3%; regional government surplus of 0.6%; and results of state companies of zero.

The interest expense trajectory of the public sector is on the rise. Still considering the 12-month comparison, public sector interest expenditures reached 6.3% of GDP (or R$ 586.4 billion) in July, against 6.4% of GDP (R$ 588.6 billion) in June and 3.9% of GDP (R$ 323.5 billion) in July 2021 (Graph 14). 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 outlook is that interest expenses will continue to rise as the average cost of the public debt increases and will remain relatively high for some months. It is worth mentioning that in Figure 14, interest expenses appear with the sign reversed on the axis.

As highlighted in previous issues of this RAF, the expected growth in interest expenses as a proportion of GDP tends to affect the trajectory of the nominal balance, making it necessary to generate higher primary surpluses to keep the nominal balance falling. Furthermore, higher interest expenses make it more challenging to stabilize the country's debt levels, requiring higher primary balances to stabilize the gross debt as a proportion of GDP.

FIGURE 14. CONSOLIDATED PUBLIC SECTOR PRIMARY AND NOMINAL BALANCES AND INTEREST EXPENDITURES - 12 MONTHS (% OF GDP)



Source: Central Bank. Prepared by: IFI.

2.4 Public sector indebtedness indicators

The interest curve in Brazil shifted in an environment of greater propensity to risk. In July, the markets were quite volatile due to uncertainties related to the global inflationary environment and the monetary policy stance in several countries. In August, on the other hand, the prospect of more favorable price dynamics in some countries, such as Brazil, led to less risk aversion. The fuel and electricity price reduction explained the deflation in July and August. The possibility of an interruption in the monetary tightening cycle contributed to the decrease in the level of the local yield curve.

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

In July, there were net redemptions of DPMFi bonds, especially fixed-rate bonds due to maturity. In primary market operations, redemptions of Federal Public Debt (DPF) securities exceeded issuances by R$ 81.6 billion in July. Fixed-rate securities determined these redemptions in the Domestic Federal Public Debt (DPMFi), which registered negative net issuance of R$ 107.5 billion. In July, there was a maturity of R$ 110.9 billion in the National Treasury Bill (LTN) and coupon payment of the National Treasury Notes series F (NTN-F) of R$ 22 billion. In the 2022 accumulated total through July, the DPMFi had net redemptions of R$ 136 billion.

In the DPMFi, July issuances were concentrated in fixed-rate and floating-rate securities (approximately R$ 26 billion each).

In July, the reduction in outstanding DPF resulted from net redemptions of fixed-rate securities. The outstanding Federal Public Debt (DPF) dropped R$ 41.2 billion in July compared to June, totaling R$ 5,804.4 billion. There were reductions of R$ 36.8 billion in the outstanding Domestic Federal Public Debt (DPMFi) to R$ 5,558.6 billion and R$ 4.4 billion in the outstanding External Federal Public Debt (DPFe) to R$ 245.8 billion. The drop in the DPF stock in July was partially offset by the appropriation of R$ 40.5 billion in interest payments. In the DPMFi, the reduction in the stock was determined by fixed-rate securities, whose balance dropped R$ 97.4 billion in July compared to the previous month due to net redemptions.

Treasury liquidity reserve remained at relatively comfortable levels in July. According to the STN, the public debt liquidity reserve was R$ 1,177.7 billion in July, compared to R$ 1,221.4 billion in the previous month and R$ 1,159.9 billion in July 2021. The liquidity reserve (also called liquidity cushion) is part of the Treasury's cash on hand deposited in the Single Account at the Central Bank. Once again, the release of resources from funds and the inflow of dividends helped maintain the Treasury's liquidity reserve in July.

The liquidity ratio, which corresponds to the sufficiency of cash to cover the maturities ahead of the DPMFi, reached 9.49 months in July, compared to 9.75 months in June and 9.56 months in July 2021. In other words, in the absence of new issuances in July, the Treasury would be able to pay 9.49 months of DPMFi maturities. The prudential value, which corresponds to the payment of three months of DPMFi bonds maturities, was R$ 505.0 billion in July, compared to R$ 555.7 billion in June.

Average issue rates at debt auctions dropped in July. Average DPMFi issue rates dropped in July, according to information presented by the STN on the RMD. However, there were oscillations throughout the month, with a rise until the 21st and a drop in the last week. For 24-month fixed-rate securities (LTN), the average issue rate was 12.94% p.a. in July, against 13.30% p.a. in June. In 48-month fixed-rate bonds, the rate was 12.75% p.a. in July, stable to the previous month. In the 10-year fixed-rate bond, with semi-annual interest payments, the average issue rate fell from 13.11% p.a. in June to 12.93% p.a. in July.

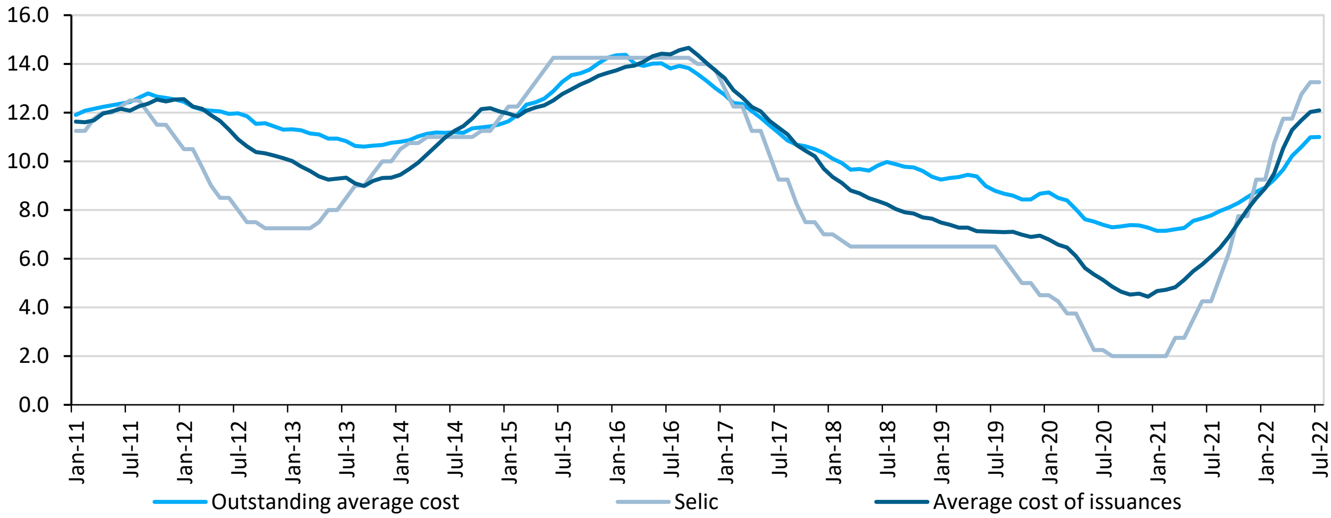
The lower risk aversion economic environment favored a new reduction in the rates of debt auctions in August. Information gathered by the IFI on Treasury auctions [12] indicates further decreases in the rates of the DPMFi bonds in August. The fixed-rate bond maturing on April 1, 2023, had an average issuance rate of 13.76% p.a. in August, against 14.01% p.a. in July. For the fixed-rate bond maturing on January 1, 2026, the average issue rate fell from 13.11% p.a. in July to 12.07% p.a. in August. Inflation-linked securities also registered a reduction in issue rates in August, in line with the price drop over the last two months. The securities (and their respective maturities) are announced quarterly by the Treasury and may change over time.

As the end of the monetary tightening cycle neared, the average cost of public debt began to stabilize in July. To conclude the analysis of debt indicators contained in the RMD, the outstanding DPMFi average cost, over 12 months, was practically stable between June (10.98% p.a.) and July (11.00% p.a.). Compared to July 2021, it rose by 3.22 p.p. (Figure 15).

The average cost of DPMFi public offerings also showed relative stability from June to July, having increased marginally from 12.03% p.a. to 12.09% p.a. in a 12-month comparison. By July 2021, the average cost of DPMFi issuances grew 6.00 p.p. (Figure 15).

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

FIGURE 15. AVERAGE PUBLIC DEBT COST (OUTSTANDING AND ISSUANCES) AND TARGET SELIC RATE



Source: STN. Prepared by: IFI.

The outstanding DPMFi average cost showed some accommodation in July, probably due to an interruption in the monetary tightening cycle conducted by the Central Bank since March of last year. Even if the Selic rate stops rising, the average cost of issuing public debt will stabilize at a relatively high level, considering the signals from the Monetary Policy Committee (Copom) that it will keep interest rates increased for several months ahead.

The reduction in the issuance rates of public bonds in July and August characterizes a more favorable condition for the Treasury, even though this relief may be momentary and is not expected to configure a reversal of the trend. Most likely, these rates will settle around the current levels and only fall when the next cycle of monetary easing gets underway.

It is also important to mention the persistence of uncertainties in the Brazilian fiscal framework as of next year. The context is one of many pressures to increase spending, at the same time as part of the increase in tax collection seen in the recent period tends to be transitory, as it is related to the price of commodities and inflation. Thus, how the question of the country's public accounts sustainability will be addressed will represent an essential element in dispelling uncertainties and regaining the credibility of fiscal policy.

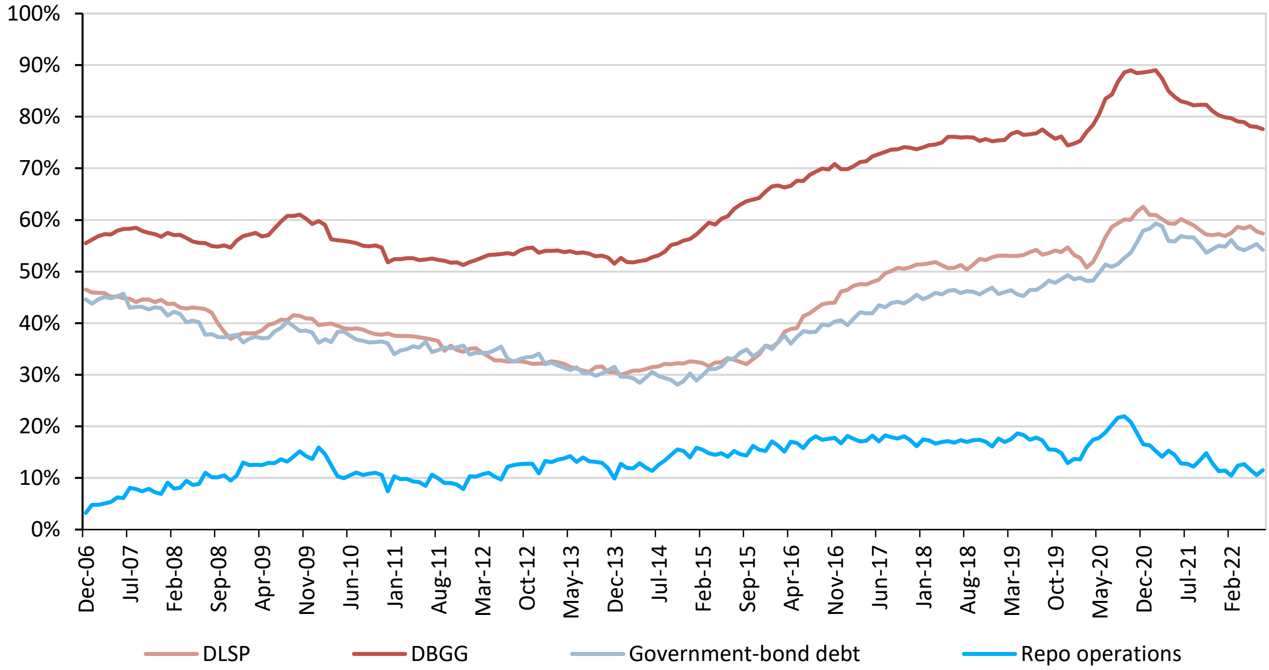
We now analyze the indebtedness indicators released by the Central Bank (methodology below the line), with information updated up to July. The General Government Gross Debt (DBGG) reached 77.6% of the GDP (R$ 7,217.1 billion) that month, a reduction of 0.4 p.p. to June and 5.1 p.p. to July 2021 (Figure 16). According to the Central Bank, this trajectory mainly reflected the nominal GDP growth (-0.9 p.p.), net redemptions of debt (-0.1 p.p.), and the accrued nominal interest (+0.6 p.p.).

The evolution of nominal GDP and the net redemptions of debt continued to be determining factors for reducing gross indebtedness in 2022. In the accumulated 2022 until July, the DBGG fell 2.7 p.p. This drop was due to the nominal GDP growth (-5.3 p.p.), net redemptions of debt (-1.7 p.p.), the accumulated exchange rate appreciation (-0.4 p.p.), and the accrued nominal interest (+4.7 p.p.). Net redemptions of debt do not necessarily indicate difficulties for the Treasury issuing securities to roll over the public debt. As mentioned previously, the liquidity reserve has allowed the Treasury to maintain the original financing plan in 2022 without carrying out significant issues in an environment of uncertainty and greater volatility.

Also, according to Figure 16, the Public Sector Net Debt (DLSP) reached R$ 5,331.8 billion (57.3% of GDP) in July, a reduction of 0.5 p.p. to June and a drop of 2.2 p.p. compared to the same month in 2021. The DLSP movement in July reflected the effects of the nominal GDP growth (-0.6 p.p.), the primary surplus (-0.2p.p.), the exchange rate variation in the basket of currencies that make up the net external debt (-0.2 p.p.), the accrued nominal interest (+0.5 p.p.), and the exchange rate appreciation (+0.1 p.p.).

In the year, the 0.1 p.p. increase in the DLSP ratio was influenced by the accrued nominal interest (+3.5 p.p.), the 7.0% accumulated exchange rate appreciation (+1.1p.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 (-3.8 p.p.), and the accumulated primary surplus (-1.6 p.p.).

FIGURE 16. PUBLIC DEBT INDICATORS AND PRINCIPAL COMPONENTS (% OF GDP)



Source: Central Bank. Prepared by: IFI.

To conclude, Table 15 presents the IFI's estimates for the DBGG in the base and alternative scenarios described above. The main difference in the assumptions lies in the consolidated public sector primary balance. In the alternative and modified alternative scenarios, the primary deficit is higher due to lower revenues (because of the extension of taxes exemption) and higher expenses (payment of the R$ 600 Brazil Aid).

Gross debt can reach 81.7% of GDP in 2023. In the base scenario, the DBGG should end 2022 at 78.1% of GDP and get 80.2% next year. In the alternative scenario, the DBGG would end 2022 at 78.0% and rise to 81.2% (an alternative scenario) or 81.7% (a modified alternative scenario) in 2023, depending on the spending trajectory.

TABLE 15. GROSS DEBT ESTIMATES - 2022 AND 2023 (R$ BILLION)

	2022		2023		
	Baseline	Alternative	Baseline	Alternative	Alternative modified
Consolidated public sector primary balance	1.3%	1.3%	0.1%	-0.4%	-0.9%
Nominal GDP (R$ billion)	9,784.9	9,785.2	10,407.9	10,434.5	10,434.5
PIB – real growth	2.6%	2.6%	0.6%	1.0%	1.0%
GDP price deflator	9.9%	9.9%	5.7%	5.5%	5.5%
Real implict rate	5.4%	5.4%	4.3%	5.5%	5.5%
DBGG (% of PIB)	**78.1%**	**78.0%**	**80.2%**	**81.2%**	**81.7%**

Source: IBGE, Central Bank. *Prepared by: IFI.*

IFI forecasts

SHORT-TERM

IFI forecasts	2022			2023		
	August	September	Comparison	August	September	Comparison
GDP – real growth (% per year)	1.99	2.61	▲	0.56	0.59	▲
Nominal GDP (R$ billion)	9,744.56	9,784.87	▲	10,382.95	10,407.87	▲
IPCA (% in the year)	7.19	6.44	▼	5.02	4.92	▼
Exchange rate – end-of-period (R$/US$)	5.26	5.2	▼	5.18	5.22	▲
Employment – growth (%)	7.06	7.3	▲	0.27	0.28	▲
Payroll – growth (%)	3.31	4.19	▲	0.56	0.59	▲
Selic rate – end-of-period (% per year)	13.75	13.75	=	10.5	10.5	=
Real interest *ex-ante* (% per year)	6.1	6.03	▼	4.83	4.91	▲
Public Sector Consolidated Primary Balance (% of GDP)	0.88	1.33	▲	0.06	0.07	▲
of which Central Government	0.28	0.73	▲	0.06	0.07	▲
Net Nominal Interest (% of GDP)	7.37	7.33	▼	6.31	6.26	▼
Nominal balance (% of GDP)	-6.5	-6	▲	-6.25	-6.19	▲
General Government Gross Debt (% of GDP)	78.82	78.05	▼	80.85	80.2	▼

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