Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

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HIGHLIGHTS

- GDP declines in the fourth quarter, bringing the output gap to the negative side again.
- IPCA should capture the impact of the federal tax increase on fuel.
- Growth in credit to individuals is concentrated in more expensive credit lines.
- Non-recurring events on revenues totaled R$ 58.1 billion in the 12 months through January.
- The projection for the federal government's primary expenditure in 2023 was revised by R$ 6.7 billion.
- IFI's forecast for the primary deficit of the central government in 2023 worsened by 0.1 p.p. of GDP.
- GDP growth attenuated the effect of the conditioning factors for the dynamics of the DLSP last year.

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Covering Letter

The Fiscal Follow-up Report (RAF) is the IFI´s monthly economic analysis and meets the purposes set forth in article 1 of Senate Resolution No. 42 of 2016. It is through the RAF that we publish our projections for the main macroeconomic and fiscal variables of the Brazilian economy.

The Federal Executive Branch signaled that the design of the sustainable fiscal regime, as provided for in Article 6 of Constitutional Amendment 126 (former Transition PEC), is ready and will be presented soon. Early disclosure in relation to the deadline provided for in the constitutional provision is important to alleviate doubts about how to finance the expansion of expenses allowed by EC 126. Thus, in the absence of clear fiscal rules, the future of public accounts remains undefined.

Uncertainties in the fiscal field are added to those of the macroeconomic scenario. GDP for the fourth quarter of 2022 fell by 0.2%, indicating a slowdown in economic activity. This result, negatively influenced by the performance of industry (from the perspective of production) and investments (from the perspective of expenditure), left a statistical carryover of 0.2% for 2023, indicating that, if it remains stagnant throughout 2023, the GDP would end the year with an increase of only 0.2%.

In light of this scenario, we maintain our forecast for economic growth at 0.9% for this year and 1.4% for next year. We emphasize that the prospect of a decrease in the pace of GDP growth in this and next year is largely explained by (i) the moderation in global economic growth, (ii) the tightening of financial conditions and (iii) the dissipation of effects of the reopening of the economy, the increase in commodity prices, and the improvement in terms of trade. Regarding item (iii), it is worth mentioning that these three vectors helped boost economic activity last year.

The inflation scenario was also maintained at 5.6% and 3.9% for 2023 and 2024, respectively. However, despite the downward bias generated by the partial (rather than total) increase in the rates levied on fuel, the projection for the year was maintained at 5.6% in view of greater pressures in the short term, evidenced in the unfavorable composition of the IPCA in February: acceleration of core and services inflation. For 2024, the IPCA is expected to fall to 3.9%, under the assumptions (i) of cooling in international commodity prices and (ii) of opening of the output gap.

In this issue of the RAF we also feature two additional analyses. The first corresponds to an update of the estimated output gap and potential GDP based on the release of national accounts data for the fourth quarter of 2022. The second additional analysis corresponds to an assessment of the credit market. In 2022 there was an increase in defaults, and we highlight in the report that the growth of credit to individuals is currently more concentrated in more expensive lines. In addition, the high level of commitment of household income to the payment of bank debts constrains the recovery of domestic consumption in the short term.

Returning to the fiscal data, we maintained the scenario for the Union's primary revenues in 2023 and 2024. The scenario for expenditures, however, underwent a marginal change: 0.1 p.p. of GDP in 2023 and 0.2 p.p. of GDP in 2024. The review of the scenario for primary expenditures was due to the innovations introduced in Provisional Presidential Decree No. 1,164, of 2023 (MP for the new Family Grant Program) and the expectation of an increase in the number of beneficiaries of the salary bonus.

Finally, it is worth mentioning that the path traced for the debt shows the size of the fiscal policy challenge. The primary surplus required to keep the debt stable at the 2022 level is around 1.5% of GDP. For 2023 and 2024, however, we project a consolidated public sector primary deficit of 1.4% and 1.2% of GDP, respectively. We hope that future signals, particularly the definition of the new fiscal anchor, will contribute to improving the economic and fiscal scenario, in order to promote the sustainability of the public debt in the medium and long term.

Vilma da Conceição Pinto
IFI Director

Summary

- In the fourth quarter of 2022, the output gap, measured as the difference (percentage) between actual GDP and potential GDP, was estimated at -0.1% (compared to +0.3% in the previous quarter). In view of the prospect of a slowdown in economic activity, it is expected that the GDP will continue to evolve below the potential level throughout the year. (Page 6)
- Provisional Presidential Decree (MP) 1,163/23 raised the ad rem rates of PIS/Cofins to R$0.47/L of gasoline and R$0.02/L of ethanol – values lower than those in force before the exemption promoted in mid-last year. As our scenario contemplated the full return of the rates, the impact on the 2023 IPCA was updated to -0.15 p.p. in this RAF, already considering the cut promoted by Petrobras. The projection for the year, however, was maintained at 5.6% in view of greater pressures in the short term. (Page 10)
- Balances and loans granted to individuals have registered growth concentrated in lines with the worst borrower profile, that is, those that do not have guarantees involved in the operations, such as credit card and overdraft. These modalities have higher bank spreads and, therefore, higher final interest rates. The increase in defaults on credit to families is related to this increase in interest rates and the greater use of more expensive lines by consumers, in a context of greater caution by banks in releasing financing. (Page 12)
- The upward revision carried out by the IFI in the projection of the central government's primary expenditure for this and next year resulted from the innovations brought by Provisional Presidential Decree No. 1,164, of 2023, which reintroduced the Family Grant Program. The article instituted additional payments conditioned to situations such as the presence of children up to six years old, pregnant women and young people from seven to seventeen years old in the families. As a proportion of GDP, the expenditure projection increased by 0.1 p.p. in 2023. (Page 23)
- The analysis of the conditioning factors of the Net Public Sector Debt in the recent period shows that the indicator has not risen more in the last two years due to the increase in nominal GDP, which partially offset the negative effects of some of the conditioning factors, such as the payment net of interest and exchange rate adjustments on the public sector balance sheet denominated in foreign currency. (Page 27)
- Information released by the Treasury in the Monthly Debt Report shows that the volume of issues has been below redemptions since the beginning of 2022, considering the comparison in 12 months. Everything indicates that the Treasury has been using the liquidity reserve to issue a smaller volume of securities due to the high average cost of public debt. Factors such as the strong inflow of dividends last year increased the liquidity reserve and favored this strategy, which may not be possible this year. (Page 27)

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1. MACROECONOMIC CONTEXT

1.1 Economic activity

Decelerating economic activity. The Gross Domestic Product (GDP) decreased by 0.2% in the fourth quarter of 2022 compared to the immediately previous quarter (slightly less than the forecast, -0.4%), after seasonal adjustment, ending the year with accumulated growth of 2.9%, slightly below expectations of 3.0%.

The result for the fourth quarter, negatively impacted by the performance of industry (from the perspective of production) and investments (from the perspective of expenditure), left a carryover of 0.2% for 2023, indicating that, if it remains stagnant throughout 2023, GDP would end the year with an increase of 0.2%.[1]

Data referring to the first months of the year, exemplified by the contraction (i) of consumer confidence and (ii) of the industry and services sectors, indicate maintenance of the downward path of economic activity. GDP in the first quarter, however, should return to growth, driven by strong grain production (a record harvest according to the Systematic Survey of Agricultural Production – LSPA/IBGE), which should more than offset the drop in other sectors.

TABLE 1. RATE OF CHANGE % OF GDP BY VOLUME

	% change against the same quarter of the previous year			% change against the previous quarter (seasonally adjusted)			% change accumulated in the year		
	Jun-22	Sep-22	Dec-22	Jun-22	Sep-22	Dec-22	2020	2021	2022
GDP	3.7	3.6	1.9	0.9	0.3	–0.2	–3.3	5.0	2.9
Supply perspective									
Agriculture and Livestock	–0.9	3.2	–2.9	–0.7	–0.5	0.3	4.2	0.3	–1.7
Industry	2.1	2.8	2.6	1.7	0.7	–0.3	–3.0	4.8	1.6
Services	4.7	4.5	3.3	1.2	0.9	0.2	–3.7	5.2	4.2
Demand perspective									
Household Consumption	5.7	4.6	4.3	2.0	1.0	0.3	–4.6	3.7	4.3
Government Consumption	0.9	1.0	0.5	–0.8	1.2	0.3	–3.7	3.5	1.5
Gross fixed capital formation	1.5	5.0	3.5	4.1	2.6	–1.1	–1.7	16.5	0.9
Exports	–4.6	8.1	11.7	–2.2	3.7	3.5	–2.3	5.9	5.5
Imports	–1.0	10.6	4.6	7.1	5.5	–1.9	–9.5	12.0	0.8

Source: Brazilian Institute of Geography and Statistics. Prepared by: IFI – Brazilian Independent Fiscal Institution.

Household consumption and the external sector sustained GDP expansion in 2022. Despite the accumulated increase in 2022, the economy slowed down compared to the previous year (when it grew by 5.0%), influenced by the lower expansion of gross fixed capital formation. The contribution of domestic absorption (sum of household consumption, government consumption and investment) to the GDP result decreased from 5.9 percentage points (p.p.) in 2021 to 2.0 p.p. in 2022, as shown in Table 2.

[1] The carryover represents the annual growth rate of the indicator assuming that its level is identical to that of the last quarter of the previous year. It thus illustrates a representation of the growth rate in the year that begins in a scenario with no negative or positive surprises.

TABLE 2. CONTRIBUTIONS TO THE REAL VARIATION OF GDP (P.P.)

	2018	2019	2020	2021	2022
GDP (change)	**1.8**	**1.2**	**–3.3**	**5.0**	**2.9**
Domestic Absorption	**2.2**	**1.8**	**–4.3**	**5.9**	**2.0**
Household Consumption	1.5	1.7	–3.0	2.4	2.6
Government Consumption	0.2	–0.1	–0.7	0.7	0.3
Investment (GFCF and changes in stock)	0.5	0.2	–0.6	2.8	–0.9
Net exports	**–0.4**	**–0.6**	**1.1**	**–0.9**	**0.9**

Source: Brazilian Institute of Geography and Statistics. Prepared by: IFI – Brazilian Independent Fiscal Institution.

While household consumption represented the main source of GDP growth in 2022 (adding 2.6 p.p. compared to 2.4 p.p. in 2021), investment (gross fixed capital formation and changes in stock) took 0.9 p.p. (against +2.8 p.p.). Net exports (exports minus imports of goods and services), in turn, added 0.9 p.p. to the 2022 result, reversing the negative influence of 2021 (-0.9 p.p.).

GDP should grow 0.9 % in 2023 and 1.4 % in 2024, at a more moderate pace compared to 2022. The prospect of a slowdown in the pace of GDP growth in this and the next year is largely explained by (i) the moderation in global economic growth, (ii) the tightening of financial conditions and (iii) the dissipation of the effects of the reopening of the economy, the increase in commodity prices, and the improvement in terms of trade (three vectors that helped boost economic activity last year).

On the other hand, the expansion of the expanded income, impacted by income from work and income transfers (Family Grant payments and real increase in the minimum wage), should provide some support for household consumption. It is worth noting that in 2022 consumption was supported by fiscal stimuli such as the expansion of the Auxílio Brasil and the release of FGTS resources.

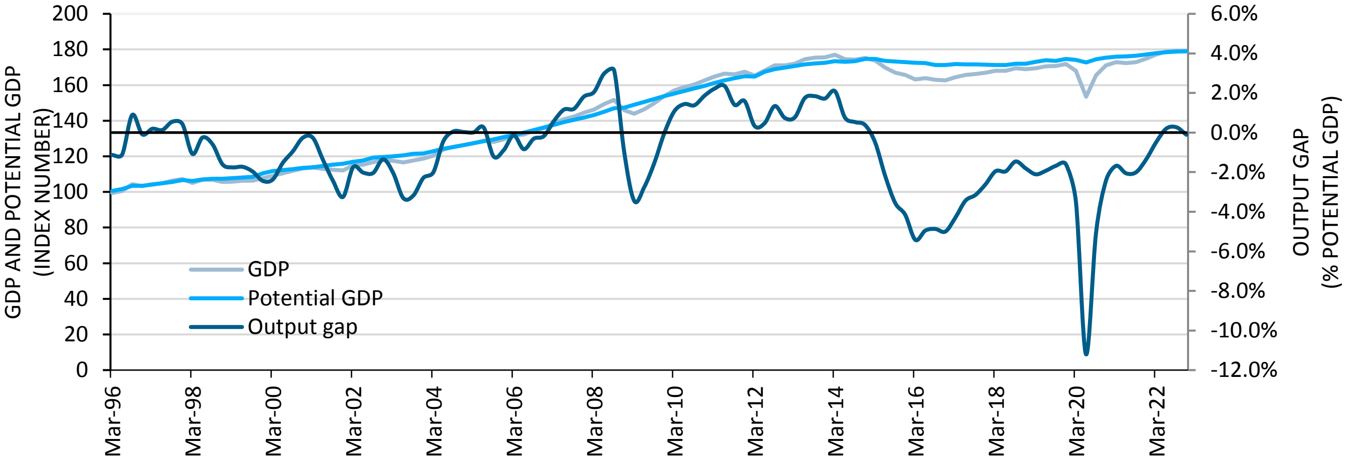
Despite the high uncertainty regarding growth in 2024, depending on the direction of economic policy and the recovery of the global economy, moderate expansion is projected (1.4%).

Slightly negative output gap in the fourth quarter of 2022. The assessment of the economy's cyclical position is conducted by the IFI using several methods, due to the high uncertainty in estimating potential output, which was exacerbated during the pandemic due to simultaneous shocks on supply and demand.[2]

In the fourth quarter, the output gap, measured as the percentage difference between actual GDP and potential GDP (medium or long-term trend), was estimated at -0.1%, against +0.3% in the previous quarter (Graph 1). In view of the prospect of a slowdown in economic activity, it is expected that the GDP will continue to evolve below the potential level throughout the year.

[2] In practical terms, as every method has its advantages and limitations, the central estimate of the output gap, for the purpose of building the macroeconomic scenario, comes from the comparison and evaluation of a set of methodologies: Hodrick–Prescott (HP) filter; multivariate HP filter, following Areosa (2008); Hamilton filter, following Quast and Wolters (2019); production functions that make use of the HP filter/multivariate HP filter/Hamilton filter; and models in state-space format, following Orair and Bacciotti (2018), to extract trends in the unemployment rate, NUCI, and total factor productivity. Trend estimates are obtained from extended historical series to minimize end-of-sample bias.

GRAPH 1. GDP AND OUTPUT GAP

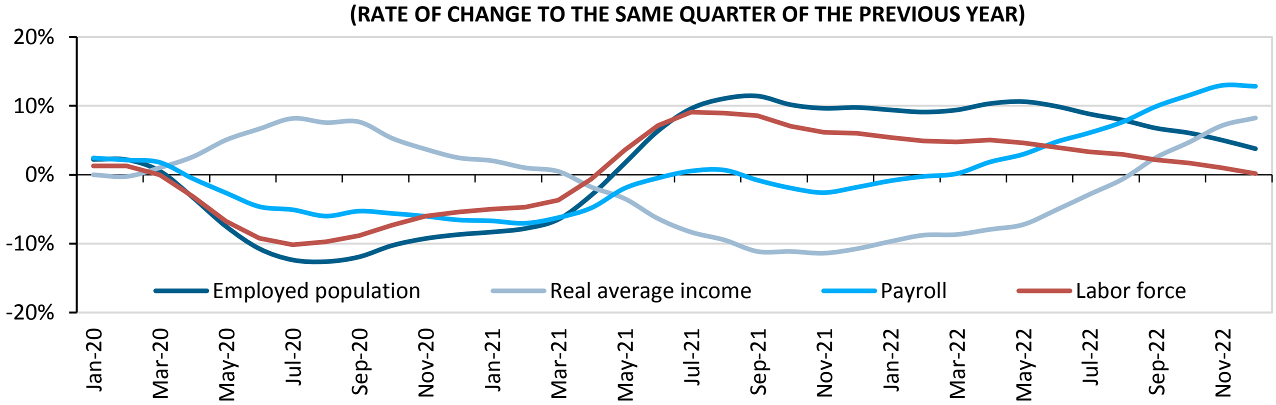


Source: IBGE and IFI. Prepared by: IFI.

1.2 Labor market

Recovery of income and slowdown in hiring. Data from the Continuous National Household Sample Survey (Continuous PNAD – IBGE) for the last quarter of 2022 showed mixed signs, with an expansion in average income and a downward trend in employment, the workforce and total payroll (Graph 2).

GRAPH 2. LABOR MARKET INDICATORS
(RATE OF CHANGE TO THE SAME QUARTER OF THE PREVIOUS YEAR)

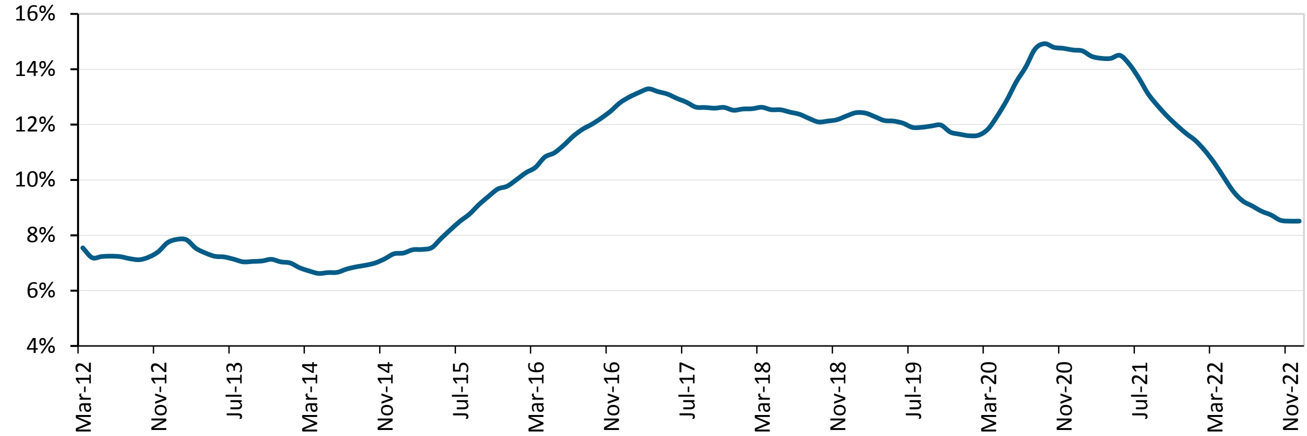


Source: IBGE. Prepared by: IFI.

Average unemployment rate declined between 2021 and 2022. In December, the unemployment rate stood at 7.9%, retreating 3.2 p.p. in the interannual comparison (Dec/2021). With the result of December, the average unemployment rate in 2022 reached 9.3%, below the level of 2021 (13.2%). Compared to 2021, the decline in the unemployment rate reflected the increase in the employed population (7.4%) by a magnitude greater than that of the workforce (2.7%).

The downward trend in the unemployment rate was interrupted by a decline in hiring and the workforce. However, considering the quarterly historical series, with seasonal adjustment, the indicator interrupted the downward path outlined since June 2021, remaining stable between November and December (at 8.5%), influenced by declines in the employed population (-0.3%) and in the labor force (-0.3%).

**GRAPH 3. UNEMPLOYMENT RATE (% OF LABOR FORCE)
SEASONALLY ADJUSTED DATA**

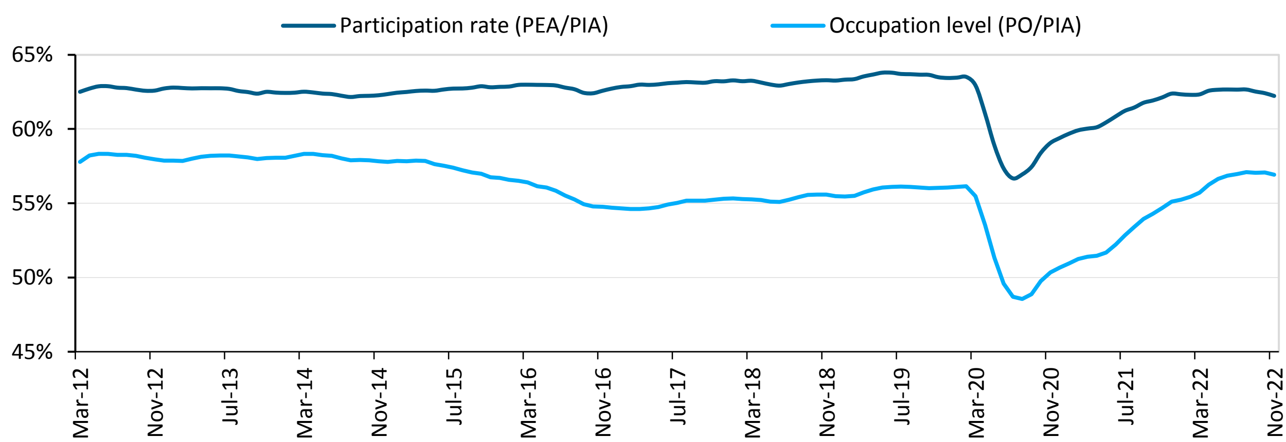


Source: IBGE and IFI. Prepared by: IFI.

Labor force participation rate remains below pre-pandemic levels. Accompanying the decrease in the workforce in the most recent quarters, the participation rate (ratio between the number of people making up the workforce and the number of people of working age) decreased to 62.0% in December (in the series with seasonal adjustment). Even with the reopening after the pandemic and the improvement in labor income, the participation rate in the labor market has not returned to the level of February 2020.

It is estimated that the seasonally adjusted unemployment rate would be 10.7% if the participation rate were at the pre-pandemic level. This calculation helps to observe that unemployment would be higher if people had not stopped looking for a job.

GRAPH 4. PARTICIPATION RATE AND OCCUPATION RATE - SEASONALLY ADJUSTED DATA



Source: IBGE. Prepared by: IFI.

The reduction in the pace of hiring, in turn, has negatively impacted the employment level (ratio between the employed population and the working-age population), which decreased from 56.9% to 56.7% between November and December (Graph 4).

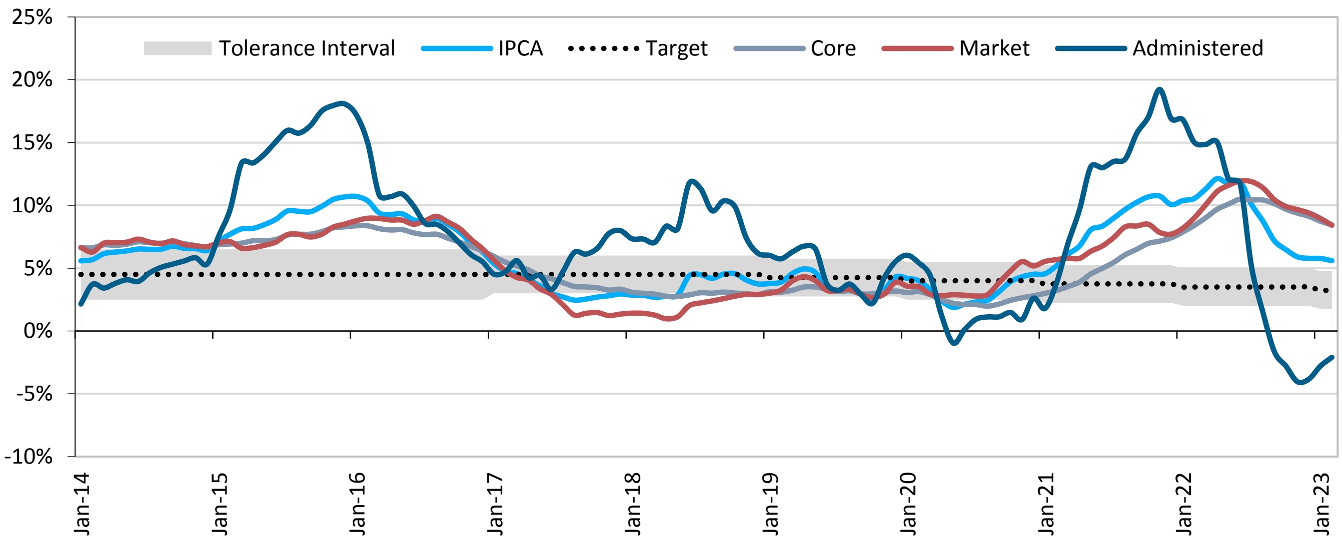
The labor market should continue to slow down in the coming months, in line with the expected path for economic activity. The average unemployment rate is projected to increase from 9.3% in 2022 to 9.5% and 9.6% in 2023 and 2024, under the assumption of a gradual recovery in the participation rate.

1.3 Inflation and monetary policy

IPCA and core inflation average accelerated in February. Consumer inflation in February, measured by the IPCA, reached 0.84%, above the rate registered in the previous month (0.53%), and influenced by readjustments in regular course fees (the impact of the Education group on the full index was of 0.35 p.p.). The accumulated variation in twelve months changed from 5.8% to 5.6%, remaining above the upper limit of the tolerance interval of 1.5 p.p. around the inflation target (3.25%) established by the National Monetary Council (CMN) for 2023.

The average of core inflation measures monitored by the Central Bank accelerated from 0.52% in January to 0.73% in February, gradually decreasing in twelve-month comparison (from 8.7% to 8.4%).[3]

GRAPH 5. IPCA (% 12 MONTHS)



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

Services inflation showed resilience. Between January and February, the change in the set of administered (or monitored) prices, which account for approximately 25% of the total IPCA, changed from 0.72% to 0.84% (Table 3), with emphasis on the increase in household electricity (1.37%). Despite the relief seen in food at home (from 0.60% to 0.04%), market prices also accelerated compared to January (0.84% compared to 0.47%), with greater pressure from industrial goods (from 0 .20% to 0.54%) and services (from 0.60% to 1.41%), mainly.

[3] Underlying inflation or core inflation is a measure that seeks to remove the influence of higher volatility items from total inflation, evidencing price trends.

TABLE 3. IPCA: CHANGE IN THE MONTH AND IN 12 MONTHS

Consumer Inflation	In the month			12 months		
	Dec-21	Jan-22	Feb-22	Dec-21	Jan-22	Feb-22
IPCA	**0.62%**	**0.53%**	**0.84%**	**5.78%**	**5.77%**	**5.60%**
Administered prices	**0.27%**	**0.72%**	**0.84%**	**-3.83%**	**-2.79%**	**-2.10%**
Free prices	**0.74%**	**0.47%**	**0.84%**	**9.39%**	**8.96%**	**8.42%**
Food at home	0.71%	0.60%	0.04%	13.21%	12.28%	10.50%
Services	0.44%	0.60%	1.41%	7.57%	7.80%	7.85%
Industrialized	1.19%	0.20%	0.54%	9.59%	8.49%	7.88%
Core inflation average	**0.66%**	**0.52%**	**0.73%**	**9.12%**	**8.73%**	**8.45%**

Source: Brazilian Institute of Geography and Statistics. Prepared by: IFI – Brazilian Independent Fiscal Institution.

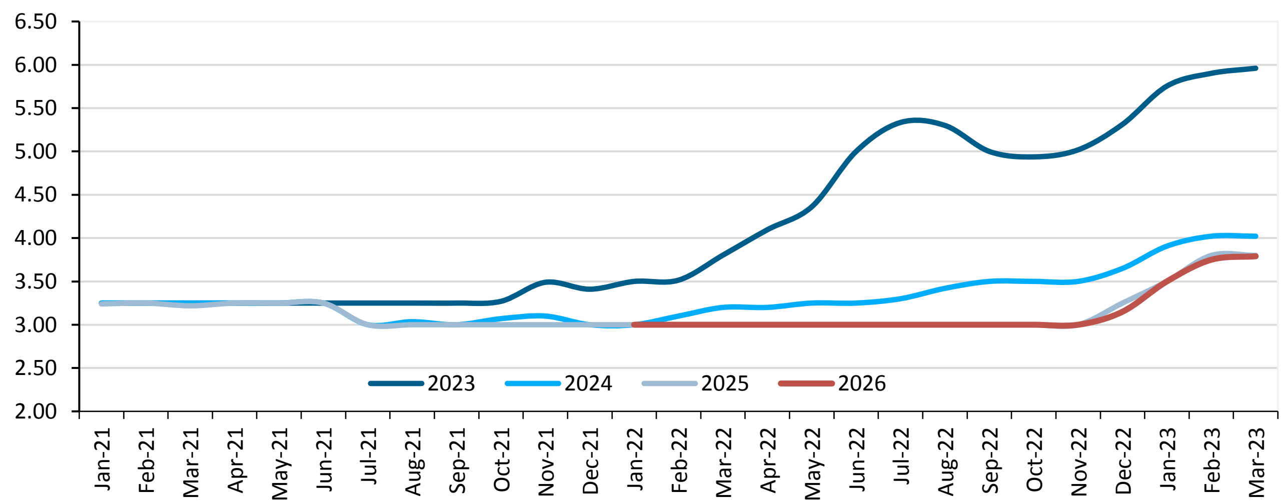
IPCA should capture the impact of the reinstatement of federal taxes on fuels that took place in March. Provisional Presidential Decree (MP) 1,163/23 raised the PIS/Cofins rates (zeroed until February 28) to R$0.47/L of gasoline and R$0.02/L of ethanol. Despite the return of taxation, the new rates are lower than those in effect before the exemption promoted in the middle of last year (R$0.69/L of gasoline and R$0.24/L of ethanol).

Simultaneously with the government's decision on federal taxes, Petrobras reduced gasoline prices charged at refineries by R$ 0.13/L, so that the net effect for gasoline was an increase of R$ 0.34/L (R$0.47/L – R$0.13/L). As our previous scenario contemplated the full return of the rates, the impact on the 2023 IPCA was updated to -0.15 p.p. in this RAF, already considering the cut promoted by Petrobras.

Projection for the 2023 IPCA remains at 5.6%. Despite the downward bias generated by the partial (rather than total) increase in the rates levied on fuel, the projection for the year was maintained at 5.6% in view of greater pressures in the short term, evident in the unfavorable composition of the IPCA in February: acceleration of the underlying and services inflation. For 2024, the IPCA is expected to fall to 3.9%, under the assumptions (i) of cooling in international commodity prices and (ii) of opening of the output gap.

Inflation expectations remain far from the target. In the Focus Bulletin, the median of expectations for the IPCA (Graph 6) stands at 5.96% for 2023, 4.02% for 2024, and close to 4.0% in the medium term (2025, 2026 and 2027). The lack of anchorage in the projections in relation to the target, explained in part by the presence of the fiscal risk, limits the existing space for the reduction of the base interest rate (currently at 13.75% per year).

GRAPH 6. FOCUS SURVEY - IPCA (% 12 MONTHS)



Source: Central Bank. Prepared by: IFI.

The scenario of deceleration in the level of activity and worsening conditions in the credit market (detailed in the next subsection), in a clearer scenario regarding the new fiscal framework and future targets for inflation, could lead the Central Bank to anticipate the interest rate reduction cycle. Despite this, the median for the Selic rate in the Focus Bulletin remains at 12.75% in 2023, with cuts of 0.50 p.p. expected for the last two meetings of the year (November and December). For 2024, the median also remains unchanged at 10.00%. In view of the signals from the Central Bank so far, demonstrating concerns about the uncertainty of the fiscal situation and the increase in inflation expectations, the IFI projection for the Selic rate in the baseline scenario (13.00% and 10.00% at the closing 2023 and 2024, respectively) is close to the market forecast.

Table 4 summarizes the IFI projections for the main economic variables in 2022, 2023 and 2024.

TABLE 4. FORECASTS - MACROECONOMIC VARIABLES

Forecasts - macroeconomic variables	2021	2022	2023	2024
Nominal GDP (R$ billion)	8,899	9,915	10,512	11,199
Nominal GDP (% annual average change)	16.9	11.4	6.0	6.5
Real GDP (% annual average change)	5.0	2.9	0.9	1.4
GDP deflator (% annual average change)	11.4	8.3	5.1	5.0
IPCA (% annual average change)	8.3	9.3	4.9	4.6
IPCA (% change year on year in December)	10.1	5.8	5.6	3.9
Unemployment rate (% of the workforce)	13.2	9.3	9.5	9.6
Exchange rate (R$/US$ end of period)	5.58	5.22	5.25	5.32
Selic (% - end of period)	9.25	13.75	13.00	10.00

Source: IBGE and Central Bank of Brazil. Projections: IFI.

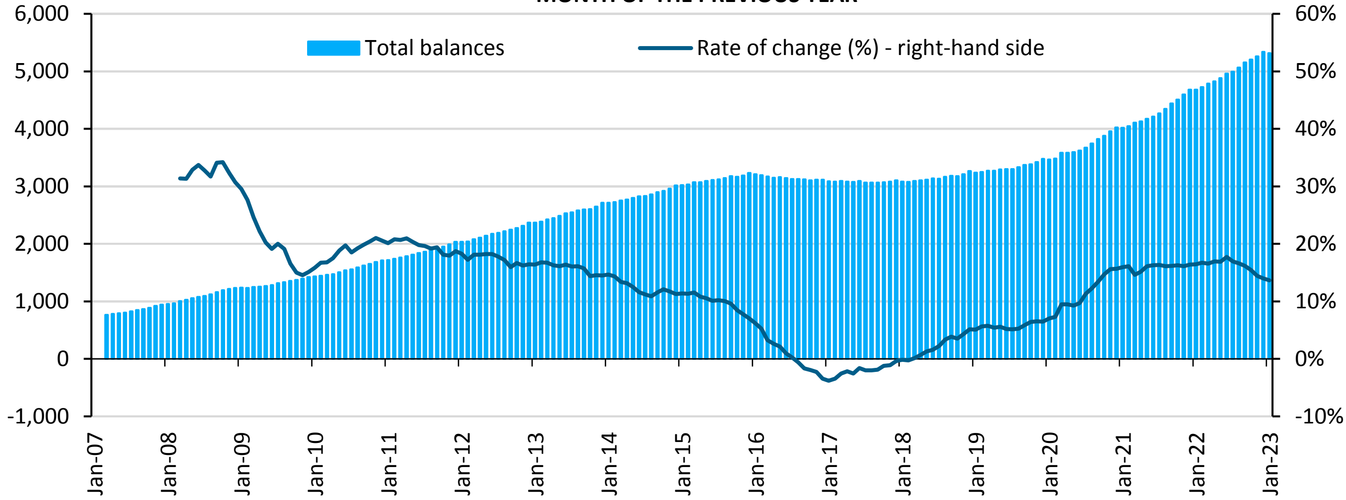
1.4 Recent evolution of the credit market

This subsection presents the most recent figures for the credit market in the Brazilian economy, whose balance, in general terms, is not favorable. Although the stock of credit is showing expansion, in real terms, in comparison with the previous year, this growth is concentrated in lines of worse quality from the point of view of guarantees offered. The current context of high interest rates, including an increase in bank spreads in financing operations, favors an increase in portfolio defaults, especially in lines aimed at individuals. Events such as the judicial reorganization of a large company in Brazil and the recent bankruptcy of two banks in the United States bring additional risks to the credit offer by expanding the risk perception of banks.

Credit stock recorded an increase of 13.6% in January in the annual comparison. According to the Central Bank, the economy's credit stock, including operations with directed and non-directed resources, reached R$ 5,317.4 billion in January, an amount 0.3% lower than that calculated in December 2022 and 13.6% higher to January 2022, both changes in nominal terms (Graph 7).[4]

[4] In the lines of loans with free resources, the interest rates of the operations are freely agreed between the financial institutions and the borrowers of the resources. In the lines with directed resources, in turn, there is some type of specific destination for the financing, having as a source of resources part of the capture of demand deposits and savings accounts, as well as funds and public programs. Interest rates are not, therefore, freely agreed upon between banks and borrowers, subject to some targeting rule.

GRAPH 7. CREDIT BALANCES (R$ BILLION) IN BANKS' PORTFOLIOS AND VARIATION RATES TO THE SAME MONTH OF THE PREVIOUS YEAR



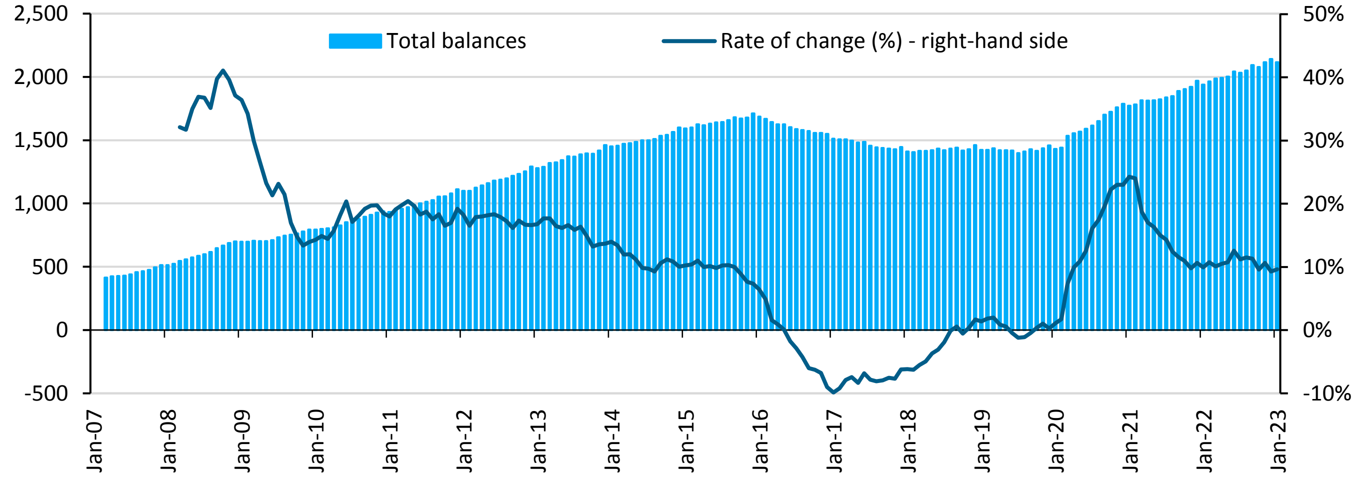
Source: Central Bank. Prepared by: IFI.

Pandemic explains credit expansion in 2020. The first fact that draws attention is the acceleration of the credit stock as of 2020. This occurred both in credit targeted at companies and in loans targeted at households. The main explanation for this phenomenon was the need for agents to mitigate the economic effects arising from the covid-19 pandemic.

In the most recent period, the loss of momentum in credit expansion in the second half of 2022 stands out, especially in the fourth quarter of the year, in line with the slowdown observed in economic activity in the period.

Credit balances destined to legal entities rose 9.2% in January. Analyzing the composition of the stock, segregating the portfolios by loans made to individuals and companies, the balances destined to companies totaled R$ 2,117.3 billion in January, an increase of 9.2%, in nominal terms, in the comparison with the same month of 2022 (Graph 8). Of this amount, R$ 736.5 billion corresponded to financing with directed resources and R$ 1,357.6 billion represented balances of loans made with non-directed resources.

GRAPH 8. CORPORATE CREDIT BALANCES (R$ BILLION) IN BANKS' PORTFOLIOS AND VARIATION RATES TO THE SAME MONTH OF THE PREVIOUS YEAR



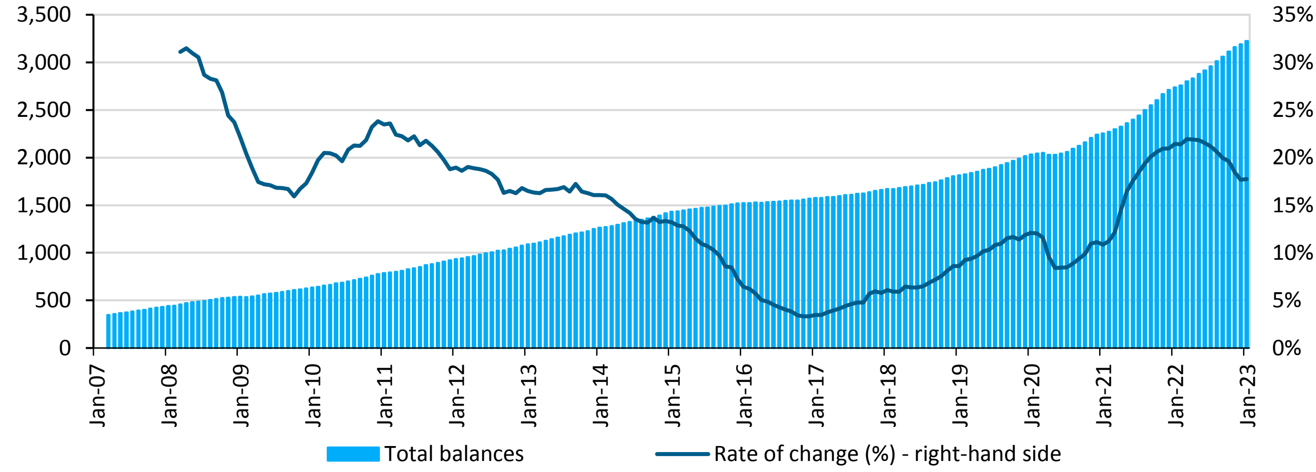
Source: Central Bank. Prepared by: IFI.

The growth in credit balances aimed at companies seen from March 2020 is related to the lines created at the time to support the operations of companies in the most acute phase of the pandemic. Among the lines created, the main one was the National Support Program for Micro and Small Businesses (Pronampe), disciplined by Law No. 13,999, of May 19, 2020. The program was made permanent by Law No. 14,161, of June 2, 2021.

Corporate credit growth occurs in good quality lines, but also in riskier lines. A more detailed analysis of the behavior of bank loans to companies reveals an expansion of the stock, in 2022, more concentrated in some lines with a lower risk profile for the borrower (better guarantees offered in operations). For example, in factoring, vehicle acquisition and acquisition of other goods, in addition to rural credit and real estate financing. On the other hand, the credit balances of some lines with a riskier profile of the borrower also record a high expansion, such as guaranteed account (a kind of pre-approved short-term working capital line) and credit card. Graph 8 shows the deceleration in balances from the second half of 2022 onwards, as explained above.

Graph 9 shows the evolution of the stock of credit in the portfolios of individuals in the financial system, as well as the rates of change in relation to the same month of the previous year in nominal terms. The behavior of values is similar to that seen in loans to legal entities: strong expansion from 2020 and deceleration in the second half of 2022.

GRAPH 9. HOUSEHOLDS CREDIT BALANCES (R$ BILLION) IN BANKS' PORTFOLIOS AND VARIATION RATES TO THE SAME MONTH OF THE PREVIOUS YEAR



Source: Central Bank. Prepared by: IFI.

Credit stock for individuals grew 17.7% in January compared to the same month of 2022. In January, the credit balance aimed at individuals was R$ 3,223.3 billion, a nominal increase of 17.7% compared to January 2022. Of this amount, R$ 1,426.6 billion (+18.0% compared to January 2022) constituted the stock of directed resources and R$ 1,796.7 billion (+17.6% compared to January 2022), the stock of non-directed resources.

Overdraft and credit cards are lines that have high variation rates in credit to individuals. Rural credit is the line that has driven the increase in the balance of loans targeted at individuals. In loans with non-directed resources, in turn, the lines that show the strongest growth are those associated with borrowers with a worse risk profile, such as credit cards and overdrafts. Signature personal loans linked to debt renegotiation also show a high pace of growth in the stock. The modalities with good associated guarantees, such as payroll-deductible loans, vehicle financing and real estate credit, grew below average.

Deterioration in labor market conditions during the pandemic may explain the increase in credit in worse quality lines. One explanation for the phenomenon described above is the deterioration of labor market conditions since the beginning of the pandemic. The unemployment rate rose, especially in segments of the labor force with less qualifications, which, in general, find employment in low-productivity service sectors. At the same time, with the pandemic, the behavior of banks became more restrictive in granting financing, which usually occurs in situations of weakening activity. Not to mention the advent of the pandemic itself, an unprecedented phenomenon.

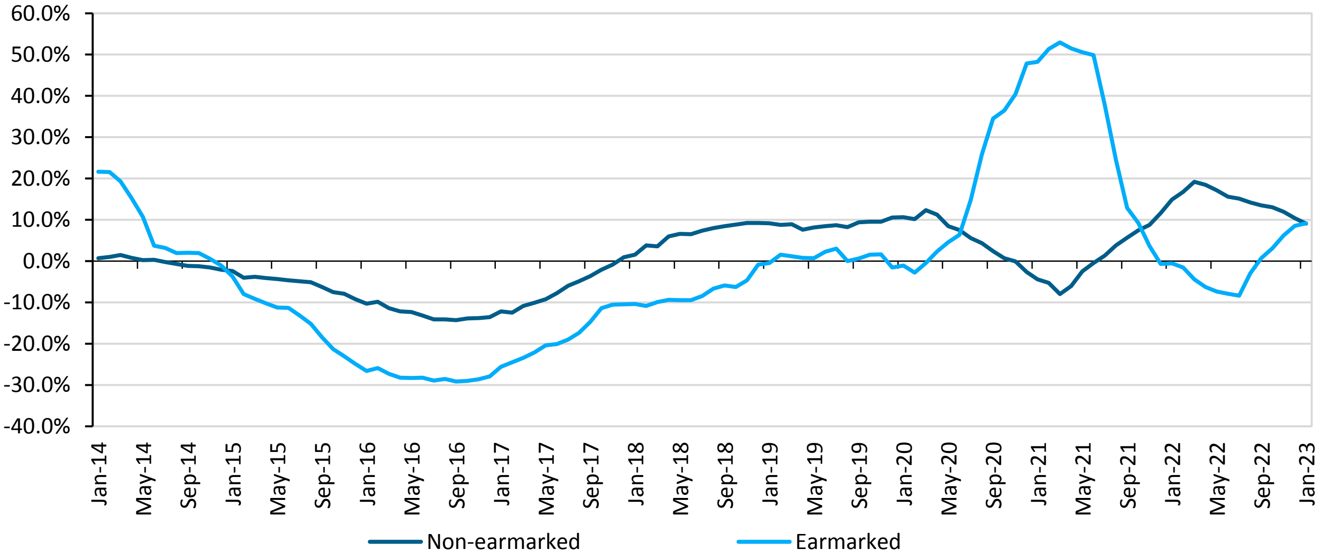
Unemployment dropped again throughout 2022, as the opening of the economy consolidated and the activities in the service sector were normalized. At the same time, the monetary tightening initiated by the Central Bank in March 2021 continued, which reinforced the more conservative behavior of financial institutions in granting credit.

Thus, the greater difficulties of borrowers to obtain loans from lines associated with better guarantees may have forced them to resort to riskier lines, such as overdraft and credit cards, which constitute loans without prior risk analysis of the borrower. For this reason, these modalities have higher associated interest rates.

Recovery of the labor market in 2022 may explain the increase in the credit stock of lines aimed at debt renegotiation. The high expansion rates recorded in the credit line linked to the renegotiation of debts indicate this greater difficulty encountered by individual borrowers from the beginning of the pandemic, as well as reflecting the improvement in the conditions of the labor market from 2022, after the opening of the economy and the stronger recovery of the service sector. Over the past year, there has been significant growth in employment (both formal and informal), which creates a more favorable environment for debt renegotiation by borrowers.

Graph 10 presents the 12-month change rate of financial system credit concessions, broken down into non-directed and directed resources. The IFI isolated the influence of inflation on the series. The loss of momentum in the growth of concessions with non-directed resources as of May 2022 is clear. In the second half of the year, in turn, the segment that influenced the increase in concessions with directed resources was rural credit, both in the portfolios of individuals and companies.

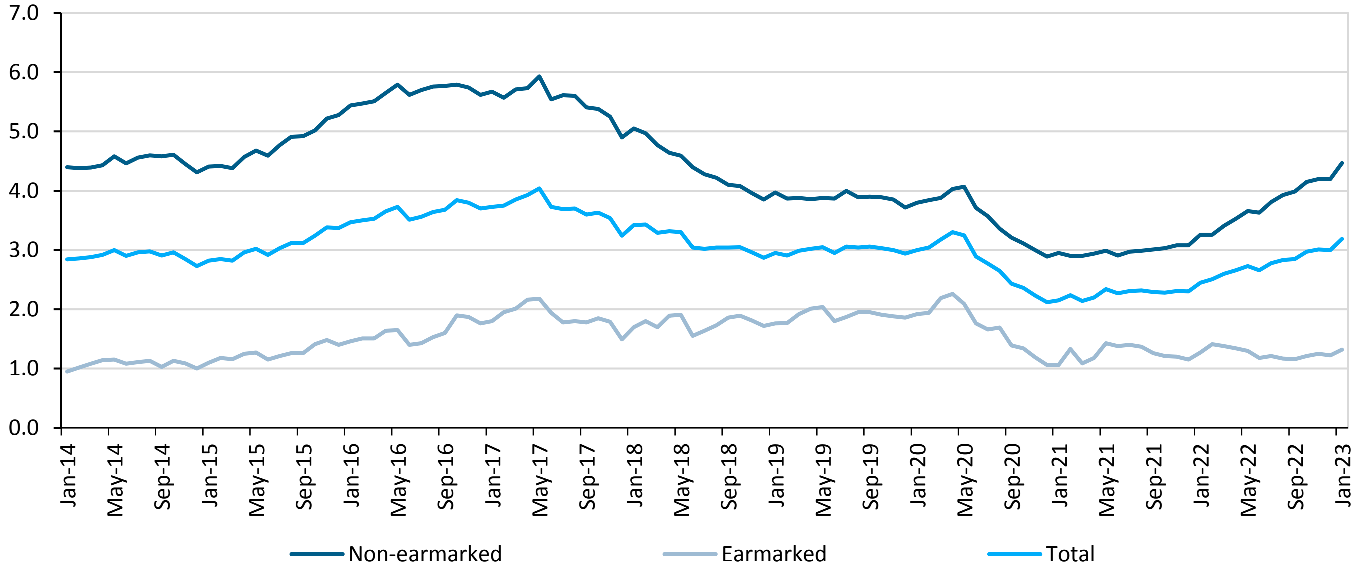
GRAPH 10 - 12 MONTH VARIATION RATE OF CREDIT CONCESSIONS - NON-EARMARKED AND EARMARKED RESOURCES - JANUARY 2023 PRICES



Source: Central Bank. Prepared by: IFI.

Bad debt had a relevant increase in 2022, driven by lines aimed at individuals. Defaults on credit portfolios, measured as the portion of balances overdue for more than 90 days, grew significantly throughout 2022, driven by the behavior of portfolios for individuals. In January 2023, defaults on credit operations in the financial system rose by 0.74 p.p. compared to January 2022, to 3.19% of the stock. In non-directed credit, the increase was 1.21 p.p., while directed credit increased by only 0.05 p.p. (Graph 11).

GRAPH 11. DELINQUENCY IN CREDIT OPERATIONS - % OF THE STOCK



Source: Central Bank. Prepared by: IFI.

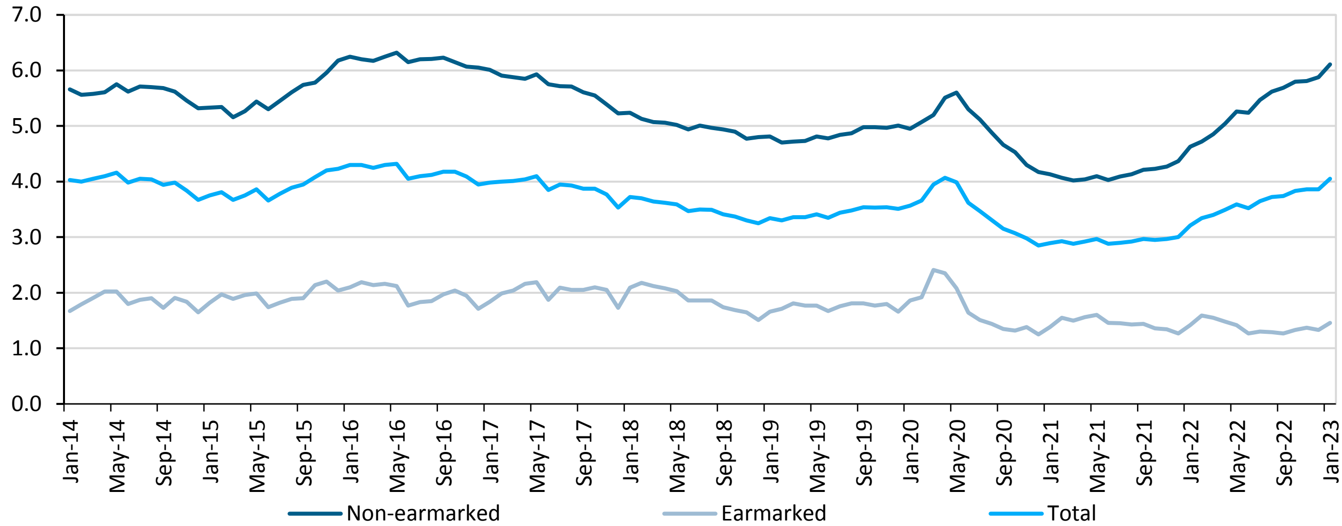
In credit lines aimed at individuals, default reached 4.05% in January, an increase of 0.84 p.p. compared to the same month of 2022. On this basis of comparison, defaults on non-directed credit increased by 1.48 p.p., while on directed credit, the indicator remained practically stable (0.04 p.p.). The upward trajectory of defaults on loans to individuals should continue in the coming months. It is also worth mentioning that the level reached in January 2023 is similar to that seen in the second quarter of 2016, at the height of the economic crisis of the 2015-2016 biennium (Graph 12).

Still in relation to the 2015-2016 period, even though the average default in operations carried out with individuals rose by around 1.5 p.p. in those months, the increase was relatively modest compared to the deterioration observed in labor market conditions in the period. Part of the explanation can be attributed to an effort made by banks to concentrate financing contracts on lines with a better risk profile for the borrower, in addition to offering better conditions for the migration of individuals from riskier lines to others with better associated guarantees.

Worse financing conditions may have explained the rise in defaults last year. In 2022, the growth of defaults in the portfolios of individuals occurred more quickly when compared to the period 2015-2016, despite the improvement observed in the conditions of the labor market in the period, which reinforces the hypothesis of influence of the deterioration in the financing conditions, especially in loan interest rates, on the worsening of default. It is worth mentioning that lines of credit with a riskier profile have higher associated interest and default rates, compared to lines with a better risk profile (good guarantees involved, such as credit for vehicles, payroll-deductible loans and real estate).

In other words, the increase in defaults on individual loan portfolios, especially in non-directed credit, is closely related to the growth of concessions and the stock of lines with worse guarantees that, in general, are released without an analysis of the borrower profile, such as credit card and overdraft.

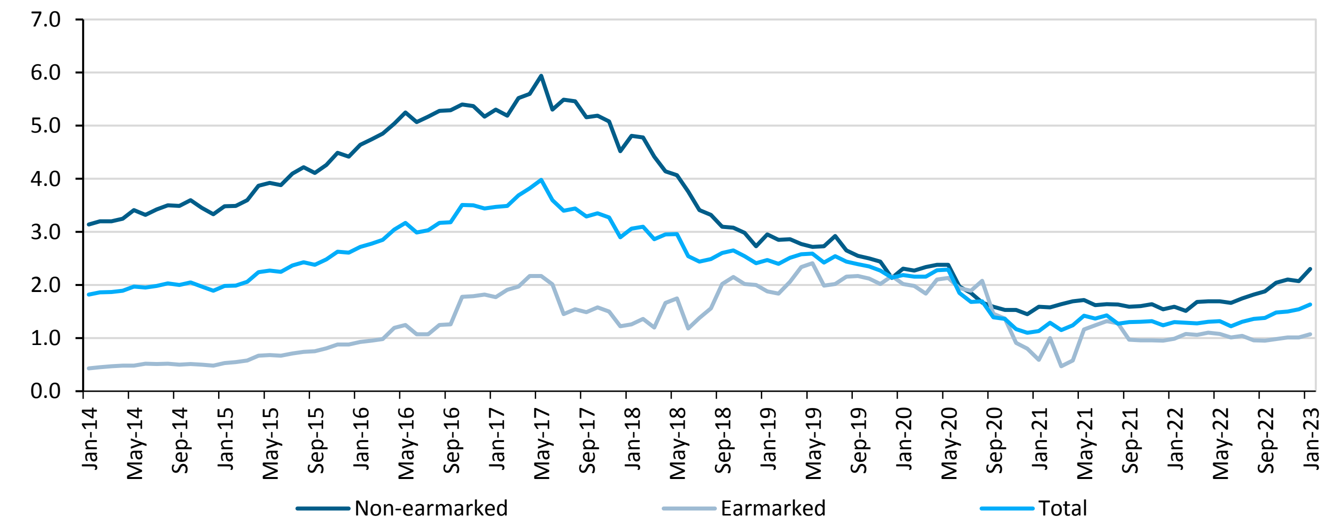
GRAPH 12. DELINQUENCY IN CREDIT OPERATIONS (HOUSEHOLDS) - % OF THE STOCK



Source: Central Bank. Prepared by: IFI.

Increase in delinquency in corporate credit was lower compared to credit targeted at families. In lines of loans destined to companies, in turn, defaults rose to a lesser extent: 0.33 p.p. in January 2023 compared to the same month of 2022, reaching 1.63%. In non-directed credit, corporate defaults grew by 0.71 p.p., to 2.30%, while in directed credit, arrears reached 1.07%, up 0.08 p.p. on this basis of comparison. Graph 13 shows this evolution.

GRAPH 13. DELINQUENCY IN CREDIT OPERATIONS (COMPANIES) - % OF THE STOCK



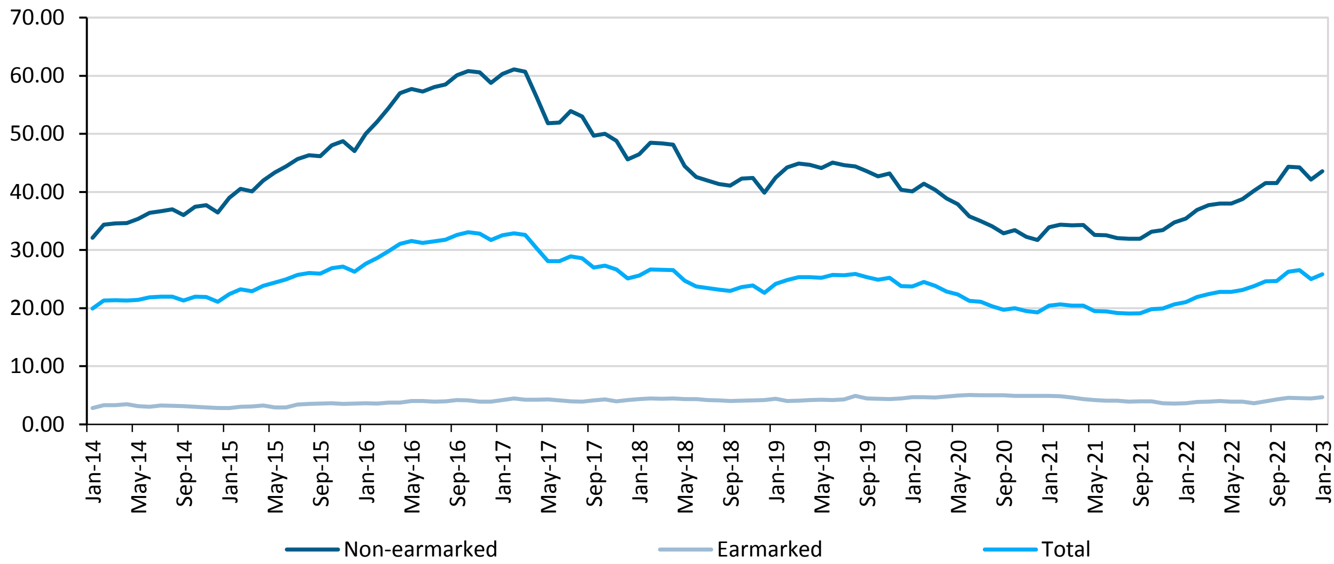
Source: Central Bank. Prepared by: IFI.

Interest charged on financing operations rose due to the increase in the Selic rate. Another important variable to be analyzed in the recent dynamics of the credit market in Brazil is the interest rates charged on financing. In general terms, rates rose following the Selic tightening cycle, initiated by the Central Bank in March 2021. As expected, the increase in rates associated with directed credit rose less than the interest rates charged on financing with non-directed resources.

Increases in financing interest rates reflect an increase in bank spreads. The spread is measured as the difference between the final financing rates and the banks' cost of funding. This basically reflects the behavior of the economy's base interest rate. Thus, to a large extent, the increases seen in the final interest on financing reflect the behavior observed in bank spreads. Spreads can also be understood as a margin charged by banks on the cost of funding, and include factors such as the risk of operations, the taxes involved in the intermediation of funds, competition and profit.

In individuals, banking spread rose 4.79 p.p. in January 2023 compared to the same month last year. Graph 14 contains the evolution of the spread in banks' individual loan portfolios. In January 2023, according to the Central Bank, the average spread was 25.83 p.p., i.e. 4.79 p.p. above that calculated in the same month of 2022. On lines with non-directed resources, the average spread of 43.54 p.p. configured an increase of 8.12 p.p. over January 2022. In turn, the spread on lines with directed funds was 4.66 p.p. in January, 1.00 p.p. above that seen a year earlier.

GRAPH 14. AVERAGE SPREADS CHARGED ON CREDIT OPERATIONS (HOUSEHOLDS) - PERCENTAGE POINTS

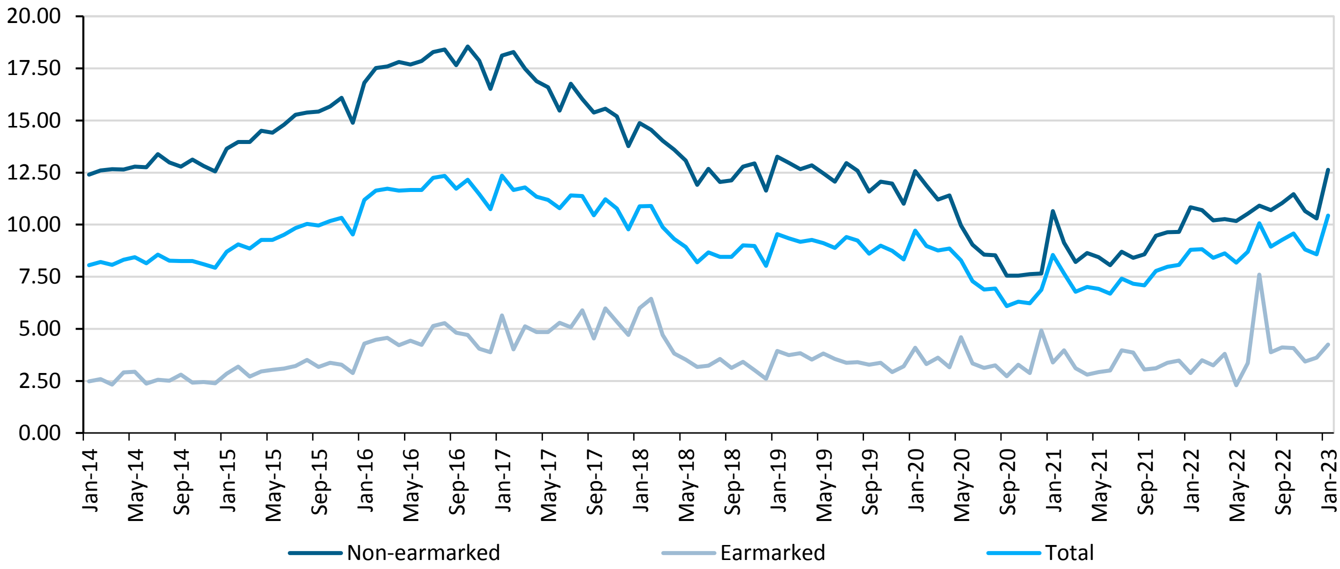


Source: Central Bank. Prepared by: IFI.

Credit growth in lines with a riskier borrower profile explains the increase observed in spreads in lines for individuals. As well as the movement observed in defaults, the growth of spreads is associated not only with the increase in base interest rates in the economy, but also with the risks associated with operations. Loans with a riskier profile (in the case of personal loans, overdrafts and credit cards) were those that grew the most in the last year. In this type of line, the spreads are higher than in lines that involve the offering of guarantees by the borrowers to the banks.

The increase in the spread in lines aimed at companies was relatively smaller. In corporate loan portfolios, the average spread was 10.43 p.p. in January, an increase of 1.64 p.p. over the same month last year. In non-directed credit, the spread of 12.63 p.p. configured an increase of 1.79 p.p. compared to January 2022. In directed credit, there was an increase of 1.36 p.p., bringing the spread to 4.24 p.p. (Graph 15).

GRAPH 15. AVERAGE SPREADS CHARGED ON CREDIT OPERATIONS (COMPANIES) - PERCENTAGE POINTS



Source: Central Bank. Prepared by: IFI.

Household income commitment increased significantly from January 2021. Finally, the commitment of household income to debt service has deteriorated significantly since the beginning of 2021. This variable, constructed by the Central Bank and whose methodology was detailed in past editions of the Quarterly Inflation Report, aims to measure the portion of household income committed to the payment of bank loan installments.[5] This is an important variable to assess the gap for credit expansion in the economy.

Commitment is influenced by the level of the expanded payroll in the economy and by financing conditions, such as average interest rates charged and transaction terms. The Central Bank separates the income commitment to debt service into two components: (i) income commitment to debt amortization, and (ii) commitment to the payment of bank interest.

In November 2022, the last month with available information, the income commitment of Brazilian families was calculated at 27.73% by the Central Bank, which can be decomposed into 18.29% with the payment of amortizations and 9.44% with interest payments on loans. In November 2021, the total commitment calculated was 26.11%, with 17.94% arising from amortizations and 8.17% due to interest (Graph 16).

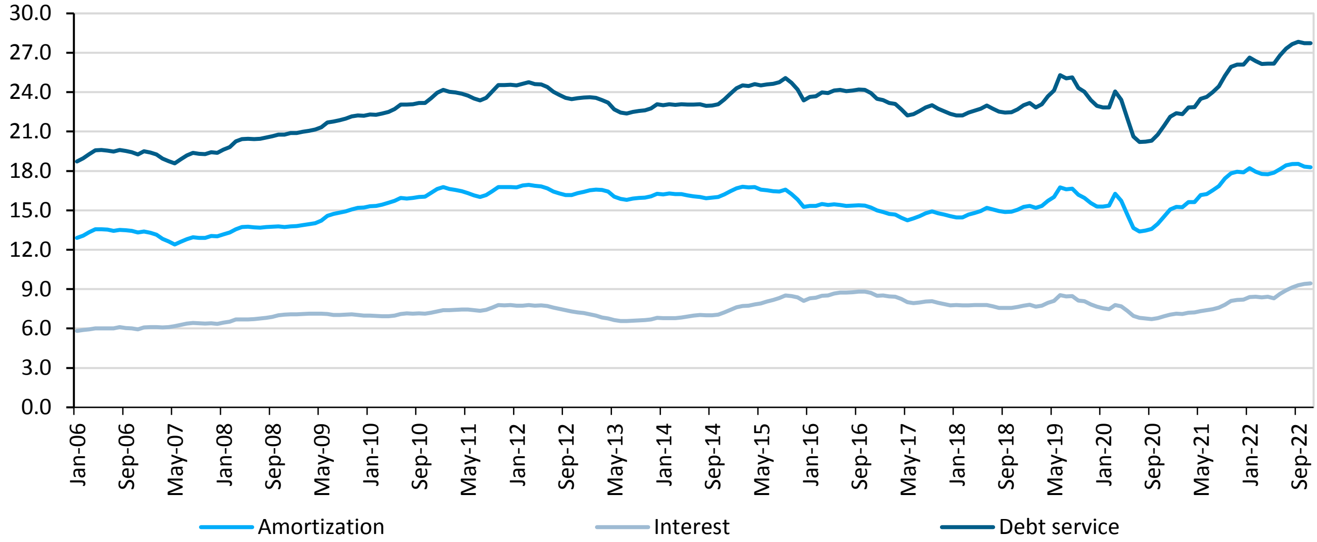
Commitment to pay interest exerted the greatest impact on the increase in commitment to debt service. Comparing November 2022 with the same month of 2021, the variations recorded in the families' income commitment were as follows: +1.62 p.p. in commitment to debt service, +1.27 p.p. in commitment with interest, and +0.35 p.p. in the amortization commitment. That is, the increase in bank spreads (and, consequently, in the final rates charged to borrowers) had a relatively greater weight in the commitment of household income in the last year.

High commitment of household income constitutes an important limiting factor for credit growth in the short term. The most recent level of household income commitment to debt service, at the highest value in the historical series, represents an important limiting factor for credit expansion in the coming months, mainly in better quality lines (lower risk profile). This perception may worsen in the event of deterioration in the conditions of the labor market, with an eventual increase in unemployment due to the cooling of economic activity.

[5] For further explanations, access, for example: https://www.bcb.gov.br/htms/relinf/port/2008/09/ri200809b2p.pdf

As previously discussed, growth in the stock of credit and loans to individuals is concentrated in lines with a riskier borrower profile. The reversal of this movement, with greater credit growth in lines with better quality of guarantees, should only occur when base interest rates in the economy fall again, favoring the reduction of defaults. This would make room for a reduction in the commitment of families' income and, consequently, for an expansion of credit on more solid bases.

GRAPH 16. HOUSEHOLD DEBT SERVICE RATIO - %



Source: Central Bank. Prepared by: IFI.

2. FISCAL SCENARIO

2.1 Primary income and transfers

Primary revenue projections for 2023 and 2024 were maintained. The IFI projection for the total primary revenue of the central government, which includes the National Treasury, the Central Bank and the INSS, was maintained at R$ 2,315.4 billion in 2023 and at R$ 2,484.6 billion next year. The projections take into account the anticipation of primary revenues and expenditures for February, carried out by the IFI in the Siga Brasil Website, of the Federal Senate, and in the Tesouro Gerencial, as well as the update of the macroeconomic projections discussed in the previous section (Table 5).

TABLE 5. CENTRAL GOVERNMENT PRIMARY REVENUE PROJECTIONS FOR 2023 AND 2024 IN THE BASELINE SCENARIO (R$ BILLION)

Baseline Scenario	2023			2024		
	Projection Feb/23	Projection Mar/23	Change	Projection Feb/23	Projection Mar/23	Change
1. Total Primary Revenue	**2,315.4**	**2,315.4**	**0.0**	**2,484.6**	**2,484.6**	**0.0**
Revenue collected by the Federal Revenue Office	1,443.2	1,443.2	0.0	1,522.0	1,522.0	0.0
Net Collection for the General Social Security System (RGPS, in the original acronym)	571.7	571.7	0.0	608.6	608.6	0.0
Revenues not Collected by RFB	300.4	300.4	0.0	354.1	354.1	0.0
2. Revenue-sharing transfers	**452.9**	**452.9**	**0.0**	**471.1**	**471.1**	**0.0**
3. Net Primary Revenue [1-2]	**1,862.5**	**1,862.5**	**0.0**	**2,013.6**	**2,013.6**	**0.0**

Source: IFI.

Between February and March, the projections of the main macroeconomic variables considered for the revenue scenarios, such as real growth, nominal GDP variation and the implicit GDP deflator, were maintained. In addition, the deviations between the projections made in February and the anticipated values in Siga Brasil and in the Tesouro Gerencial do not justify a change in the values previously projected for 2023 and 2024.

In addition to maintaining the macroeconomic projections, the IFI already considered, in the projections released in February, the recomposition of revenue with PIS/Cofins on fuels, in the order of R$ 28.8 billion. Despite the government having announced a partial recomposition of the PIS/Cofins rates in MP No. 1,163, of 2023, the text of the MP provides for a complementary source of revenue from the provisional taxation of crude oil exports, in the amount of 9.2%, until June 30, 2023. In this way, the IFI maintained the expectation of recomposition of R$ 28.8 billion on managed revenue in 2023.

By way of comparison, the median projections of the March 2023 Prisma Fiscal Report, by the Ministry of Finance, predicted a federal revenue collection of R$ 2,341.6 billion, in 2023, and R$ 2,472.2 billion in 2024.[6] The average of Podium forecasts, the set of institutions that are most correct, is a total primary revenue of R$ 2,360.5 billion this year and R$ 2,526.1 billion in the next.

As the IFI projections for revenue-sharing transfers this year and next were maintained, the forecasts for net primary revenue were also the same as those presented in February, namely, R$ 1,862.5 billion in 2023 and R$ 2,013.6 billion in 2024 (Table 5). Comparing with the projections sent to Prisma Fiscal, the March median consisted of R$ 1,920.0 billion for the central government's net revenue this year and R$ 2,046.5 billion in 2024, while the Podium average was a value of R$ 1,922.2 billion and R$ 2,085.3 billion, in that order.

Based on the information disclosed by the National Treasury Secretariat (STN) in the National Treasury Result Bulletin (RTN), updated until January, the IFI updated the central government recurring primary revenue series. In the 12 months through January, primary revenue totaled R$ 2,333.7 billion (23.5% of GDP), while recurring primary revenue was R$ 2,275.5 billion (22.9% of GDP). Graph 17 shows the evolution of the two indicators.

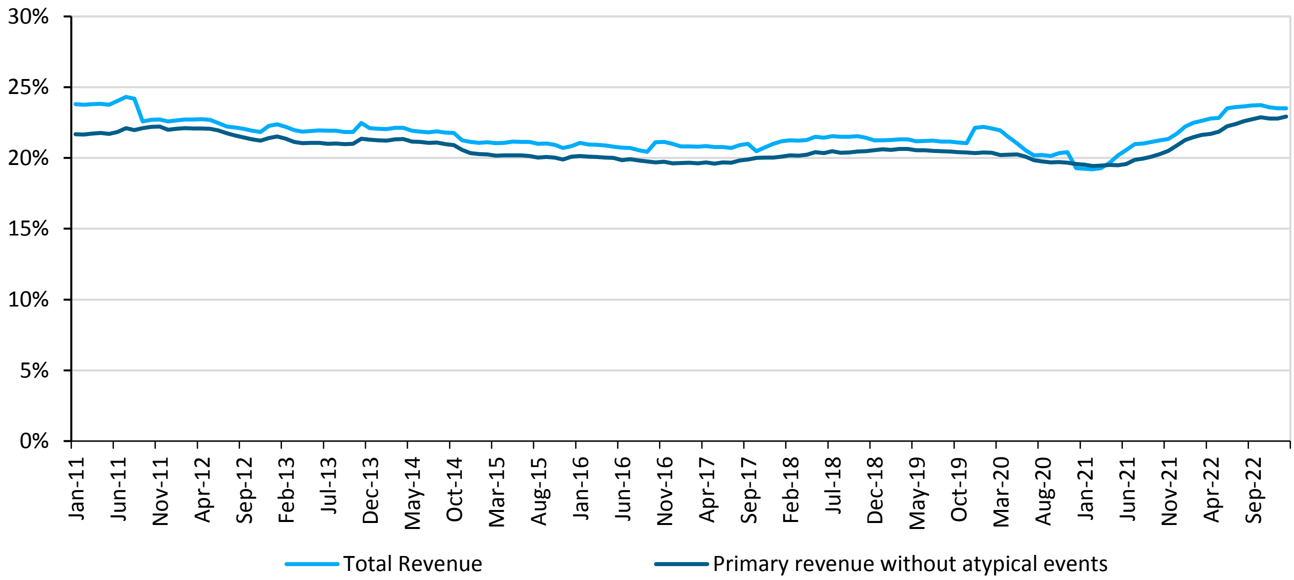
Total and recurring primary revenues exhibit accommodation at a relatively high level. In Graph 17, it is possible to see a slowdown in the trajectory of the Union's primary revenues, in line with the slowdown observed in domestic

[6] Link to access the report: .https://www.gov.br/fazenda/pt-br/centrais-de-conteudos/publicacoes/relatorios-do-prisma-fiscal/relatorio-mensal/2023/relatorio-mensal-2023_03-v2.pdf/view

economic activity in the fourth quarter of last year. This movement reinforces the perception of a more moderate increase in tax collection in 2023 and more in line with nominal GDP growth.

Non-recurring events on revenues totaled R$ 58.1 billion in the 12 months through January. The difference between conventional and recurring primary revenue in the comparison of the 12 months ending in January was R$ 58.1 billion (R$ 2,333.7 billion minus R$ 2,275.5 billion) and corresponds precisely to the amount of atypicalities present in revenue of the central government. Of the sum of R$ 58.1 billion, (i) R$ 14.4 billion consisted of non-recurring factors in managed revenue, such as special installments (Refis), atypical payments of IRPJ and CSLL, and the reduction of PIS/Cofins on fuels; (ii) R$1.8 billion corresponded to atypical payments in the net collection for the RGPS (Refis); and (iii) R$42.0 billion represented atypical events on unmanaged revenues (concessions and grants signed by the Union). These values are displayed in Table 6.[7]

GRAPH 17. 12-MONTH EVOLUTION OF CONVENTIONAL AND RECURRENT PRIMARY REVENUE (% OF GDP)



Source: National Treasury Secretariat. Prepared by: IFI.

Still in the 12 months ended in January, there were R$ 19.1 billion in atypical transfers from the Union to subnational entities (extraordinary collections of IR and sharing of revenues from the onerous transfer of the pre-salt layer).

7 The non-recurring events considered are described in the Special Study (EE) of IFI No. 17, of December 2021, and include payments from special installments (Refis), anticipation of dividends, operations with assets and other atypical payments reported by the RFB. Link to access the document: https://www2.senado.leg.br/bdsf/bitstream/handle/id/594656/EE17_Resultado_Estrutural.pdf

TABLE 6. CONVENTIONAL AND RECURRING REVENUES IN THE 12 MONTHS UNTIL JANUARY 2023 (R$ BILLION)

	12 months to January 2023		
	Conventional revenue	Recurring revenue	Non-recurring revenue
1. Total Primary Revenue	**2,333.7**	**2,275.6**	**58.1**
Revenue collected by the Federal Revenue Office	1,400.4	1,386.1	14.4
Net Collection for the General Social Security System (RGPS, in the original acronym)	541.9	540.1	1.8
Revenues not Collected by RFB	391.4	349.4	42.0
2. Revenue-sharing transfers	**460.7**	**441.6**	**19.1**
3. Net Primary Revenue [1-2]	**1,873.0**	**1,834.0**	**39.0**

Source: National Treasury Secretariat and IFI.

2.2 Primary expenditure

IFI revises the scenario for the Union's primary expenditures by R$ 6.7 billion, in relation to the February scenario. The Union's primary expenditures should end 2023 at R$ 1,987.5 billion (18.9% of GDP). This number is relatively higher than the IFI projection made in February 2023 (18.8% of GDP). This new scenario for 2023 basically stems from changes in the forecast for salary bonuses and the Family Grant Program (PBF). Thus, the changes promoted by Provisional Presidential Decree No. 1,164, of March 2, 2023, which changed the conditional income transfer program, contributed to the review.[8] The MP recreated the Family Grant program and extinguished the current Auxílio Brasil (PAB) program. With regard to the revision of the projection for the wage bonus and unemployment insurance item, the announcement of a new processing promoted by Dataprev contributed to the revision, which should allow more than 2.7 million workers to still be entitled to the benefit.[9] Table 7 compares the IFI scenario for 2023, with the February RAF projections and those presented this month.

TABLE 7. UNION PRIMARY EXPENDITURE - IFI BASE SCENARIO FOR 2023 (JAN X FEB) (R$ BILLION)

Breakdown	IFI (on Feb/23)		IFI (on Mar/23)		Difference		
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	%	p.p. of GDP
Primary Expenditure	**1,980.8**	**18.8**	**1,987.5**	**18.91**	**6.7**	**0.3**	**0.1**
Mandatory Expenditure	**1,814.5**	**17.2**	**1,821.3**	**17.33**	**6.8**	**0.4**	**0.1**
Social Security	866.8	8.2	866.8	8.25	0.0	0.0	0.0
Personnel	356.4	3.4	356.4	3.39	0.0	0.0	0.0
Salary Bonus and Unemployment Benefit	67.8	0.6	69.2	0.66	1.5	2.2	0.0
BPC [Continuous Cash Benefit Program]	86.6	0.8	86.6	0.82	0.0	0.0	0.0
Family Grant / Auxílio Brasil	174.4	1.7	179.7	1.71	5.3	3.1	0.1
Court-Ordered Debts (costing and capital)	23.6	0.2	23.6	0.22	0.0	0.0	0.0
Complementation to FUNDEB	38.7	0.4	38.7	0.37	0.0	0.0	0.0
Subsidies and Grants	20.3	0.2	20.3	0.19	0.0	0.0	0.0
Legislative, Judiciary, Prosecutor's Office and Public Defender's Office	16.1	0.2	16.1	0.15	0.0	0.0	0.0
Payroll tax exemption	0.0	0.0	0.0	0.00	0.0	0.0	0.0
Extraordinary credits	5.0	0.0	5.0	0.05	0.0	0.0	0.0
Other Mandatory Spending	158.9	1.5	158.9	1.51	0.0	0.0	0.0
Discretionary Spending of the Executive Branch	**166.3**	**1.6**	**166.2**	**1.58**	**–0.1**	**–0.1**	**0.0**

Source: STN, Budgetary and Financial Programming Decree and IFI. Prepared by: IFI – Brazilian Independent Fiscal Institution.

[8] Available at: https://www.planalto.gov.br/ccivil_03/_ato2023-2026/2023/mpv/mpv1164.htm

[9] See news at: https://www.gov.br/trabalho-e-previdencia/pt-br/noticias-e-conteudo/trabalho/2023/fevereiro/mais-de-2-7-milhoes-de-trabalhadores-ainda-poderao-receber-o-abono-salarial

According to MP No. 1,164, of 2023, in addition to the regular monthly benefit of at least R$ 600 per family, the new PBF will also have additional benefits of R$ 150 per child up to six (6) years old and R$ 50 per beneficiary from 7 (seven) to 17 (seventeen) years old and pregnant women. These additional benefits of R$ 50 were not contemplated in the previous IFI scenario, so that the increase in PBF expenses resulted from these adjustments. It is worth mentioning that the regular benefit of R$ 600 was being paid since the beginning of the year, but the additional benefits have different durations. The R$ 150 benefit began to take effect in March 2023, while the R$ 50 benefits are expected to begin in June. Another important change in the PBF MP is the criteria for classifying families eligible for the program. According to item II of article 5 of MP 1,164, the monthly per capita family income must be equal to or less than R$ 218 for the family to be eligible for the program.

In 2024, the Union's primary expenditures as a proportion of GDP should remain practically stable compared to 2023. Although there are still uncertainties regarding the new fiscal rule and, consequently, the future dynamics of primary expenditures, it is possible to outline a scenario based on the rules currently in force.[10] Thus, when considering the current expenditure ceiling rule, the new permanent expenditures introduced by EC 126 (Transition EC) and the growth dynamics of other expenditures, it is observed that the Union's primary expenditure should present a nominal growth of R$ 135.3 billion. As a proportion of GDP, however, expenditures should remain relatively stable. Table 8 details the main expenditure items in the IFI scenarios for 2023 and 2024.

TABLE 8. PRIMARY UNION EXPENDITURE - IFI BASELINE SCENARIO FOR 2023 AND 2024 (R$ BILLION AND % OF GDP)

Breakdown	2022 (Realized)		IFI (Scenario 2023)		IFI (Scenario 2024)		Difference (p.p. of GDP)	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP	22 - 23	23 - 24
Primary Expenditure	**1,802.0**	**18.2**	**1,987.5**	**18.9**	**2,122.8**	**19.0**	**0.7**	**0.0**
Mandatory Expenditure	**1,649.9**	**16.6**	**1,821.3**	**17.3**	**1,945.8**	**17.4**	**0.7**	**0.0**
Social Security	797.0	8.0	866.8	8.2	936.5	8.4	0.2	0.1
Personnel	337.9	3.4	356.4	3.4	381.6	3.4	0.0	0.0
Salary Bonus and Unemployment Benefit	64.3	0.6	69.2	0.7	74.2	0.7	0.0	0.0
BPC [Continuous Cash Benefit Program]	78.8	0.8	86.6	0.8	93.9	0.8	0.0	0.0
Family Grant / Auxílio Brasil	88.1	0.9	179.7	1.7	182.9	1.6	0.8	–0.1
Court-Ordered Debts (costing and capital)	17.3	0.2	23.6	0.2	26.9	0.2	0.0	0.0
Complementation to FUNDEB	32.9	0.3	38.7	0.4	45.6	0.4	0.0	0.0
Subsidies and Grants	15.3	0.2	20.3	0.2	21.1	0.2	0.0	0.0
Legislative, Judiciary, Prosecutor's Office and Public Defender's Office	15.0	0.2	16.1	0.2	16.7	0.1	0.0	0.0
Payroll tax exemption	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Extraordinary credits	47.0	0.5	5.0	0.0	0.0	0.0	–0.4	0.0
Other Mandatory Spending	153.1	1.5	158.9	1.5	166.3	1.5	0.0	0.0
Discretionary Spending of the Executive Branch	**152.1**	**1.5**	**166.2**	**1.6**	**177.0**	**1.6**	**0.0**	**0.0**

Source: STN and IFI. Prepared by: IFI – Brazilian Independent Fiscal Institution.

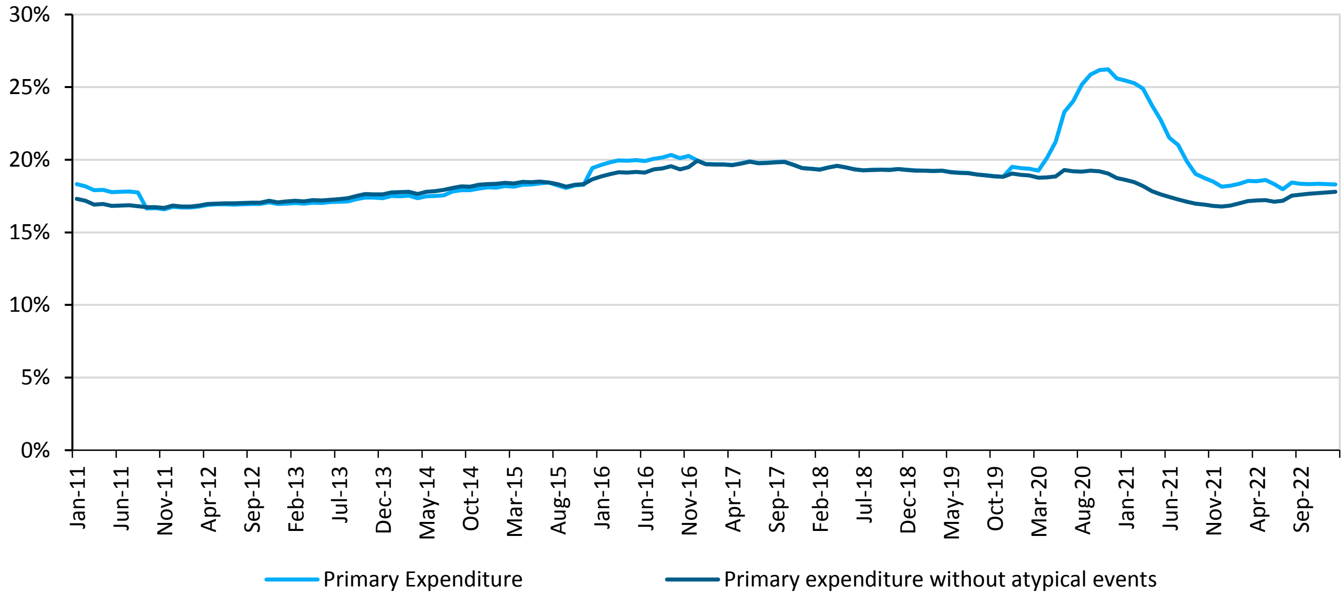
The central government's recurring primary expenditure, calculated by the IFI based on the methodology disclosed in EE No. 17, of December 2021, totaled R$ 1,766.3 billion (17.8% of GDP) in the 12 months through January 2023, an increase real of 7.8% over January 2022, when there was a drop of 3.2% compared to 2021. The calculation considers as non-recurring expenses related to Covid-19, the onerous transfer of the pre-salt, the Sovereign Wealth Fund of Brazil,

[10] Until the publication of this RAF, the sustainable fiscal regime referred to in article 6 of Constitutional Amendment No. 126 of 2022 had not been disclosed.

advances in the payment of the salary bonus and the 13th salary of the RGPS, and other expenses, such as the payment for the right of use Campo de Marte and the grants created with Constitutional Amendment (EC) No. 123, of 2022, with the exception of the additional R$ 200 paid to beneficiaries of the Auxílio Brasil (classified under the heading of extraordinary credits between August and December 2022).[11] This expense was not considered non-recurring due to the continuity of the benefit in 2023, disciplined in EC No. 126.

The federal government's recurrent primary expenditure grew by 1.0 p.p. of GDP between January 2022 and January 2023. Graph 18 shows the 12-month evolution of total and recurrent primary expenditure, measured as a proportion of GDP and calculated by the IFI according to the methodology presented in EE No. 17, of December 2021. Total primary expenditure reached 18.3% of GDP in January, stable for the fifth consecutive month. Expenditure without atypical (or recurring) expenses remained stable at 17.8% of GDP in January. However, between January last year and January 2023, recurring expenses rose by 1.0 p.p. of GDP.

GRAPH 18. EVOLUTION IN 12 MONTHS OF TOTAL CONVENTIONAL AND RECURRENT PRIMARY EXPENDITURE - % OF GDP



Source: National Treasury Secretariat. Prepared by: IFI.

Atypical expenditures totaled R$ 51.1 billion in the 12 months ended in January. In the 12 months up to January 2023, non-recurring expenses totaled R$ 51.1 billion (out of a total of R$ 1,817.4 billion, or 2.8%) and came from expenses with equalization of liabilities, expenses aimed at combating the pandemic, the payment made by the Union to the Municipality of São Paulo for the right to use Campo de Marte Airport, and aid (to taxi drivers and truck drivers) and financial support to the states and the Federal District. Table 9 presents these values.

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[11] It is worth mentioning that in annualized terms, the effect of these advances may be null, but in monthly analyses, there is a change in the seasonal pattern of the series due to the change in the calendar.

TABLE 9. NON-RECURRING EXPENSES OF THE CENTRAL GOVERNMENT IN 12 MONTHS UNTIL JANUARY 2023 (R$ BILLION)

	Non-recurring expense
Equalization of liabilities and expenses of Covid-19	16.8
Campo de Marte	23.9
Financial aid to the States and DF	3.6
Grant for truck drivers	2.3
Grant for taxi drivers	1.9
Financial assistance from the Union to the States and DF	2.5
Total	**51.1**

Source: IFI.

2.3 Central government primary result

Based on the projections presented in the two previous subsections for the Union's net revenue and primary expenditure, Table 10 contains a comparison of the values projected in February and March by the IFI for the primary result of the central government in 2023 and 2024.

Revisions in expenditure projections have worsened the primary deficit forecast for this year and next. Between February and March, the expectation for the primary deficit in 2023 was revised downwards, from R$ 118.3 billion (1.1% of GDP) to R$ 125.0 billion (1.2% of GDP) due to of the slight increase in the projection of expenditure by 0.1 p.p. of GDP. For 2024, the IFI projection for the primary deficit changed from 0.9% to 1.0% of GDP, also influenced by the upward revision of primary expenditure growth, of 0.2 p.p. of GDP.

TABLE 10. CENTRAL GOVERNMENT PRIMARY RESULT AND PROJECTIONS FOR 2023 AND 2024, IN THE BASELINE SCENARIO (R$ BILLION)

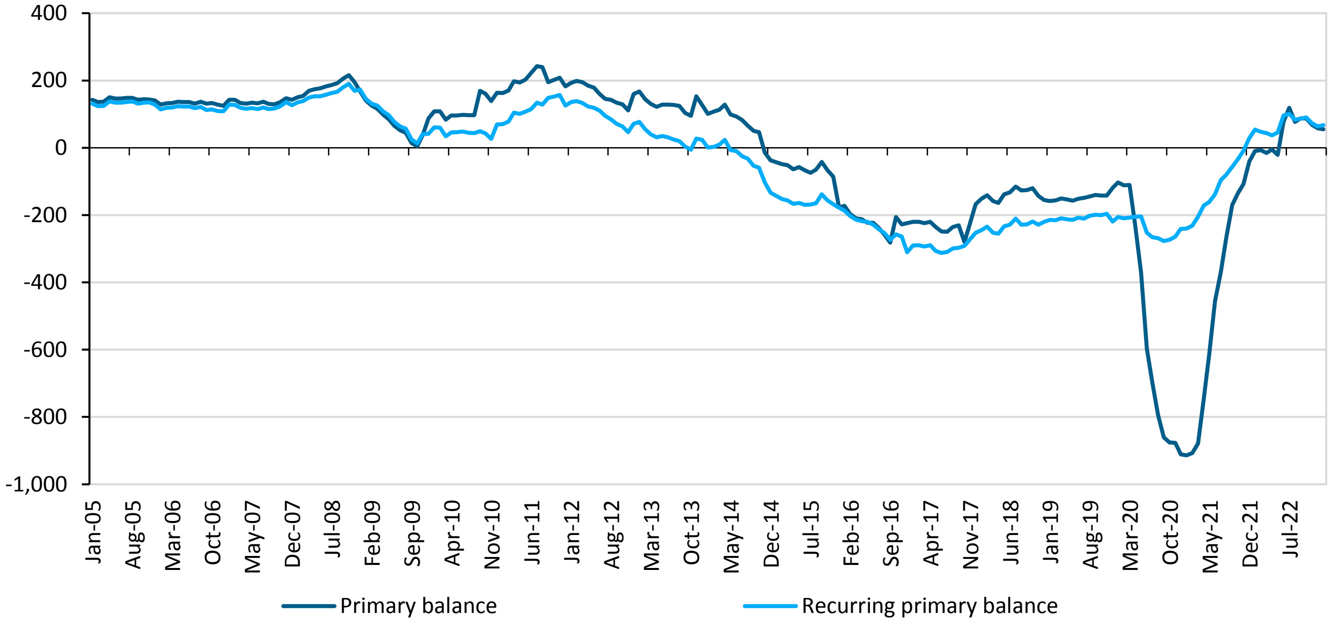
Breakdown	2021		2022		2023*				2024*			
					Projection Feb/23		Projection Mar/23		Projection Feb/23		Projection Mar/23	
	Value	% of GDP	Value	% of GDP	Value	% of GDP	Value	% of GDP	Value	% of GDP	Value	% of GDP
Net Revenue	1,579.1	17.7%	1,856.1	18.7%	1,862.5	17.7%	1,862.5	17.7%	2,013.6	18.0%	2,013.6	18.0%
Primary expenditure	1,614.2	18.1%	1,802.0	18.2%	1,980.8	18.8%	1,987.5	18.9%	2,111.1	18.8%	2,122.8	19.0%
Primary Result	**–35.1**	**-0.4%**	**54.1**	**0.5%**	**–118.3**	**-1.1%**	**–125.0**	**-1.2%**	**–97.5**	**-0.9%**	**–109.3**	**-1.0%**

** 2023 and 2024: projections*
Source: IBGE and Central Bank of Brazil. Prepared by: IFI – Brazilian Independent Fiscal Institution.

Graph 19 shows the 12-month trajectory of the conventional (observed) and recurrent primary results of the central government at February 2023 prices. While the conventional result was a surplus of R$ 54.9 billion in January, the recurring result was positive at R$ 67.2 billion. The two primary result curves show a reduction in the surplus during the second half of 2022 due to an increase in expenditure compared to net revenue. Throughout 2023, these curves should return to negative values.

A slowdown in economic activity, sources of financing for expenditures and the fiscal regime may pose risks to fiscal policy. As mentioned in the last editions of the RAF, the expected slowdown in domestic economic activity in the coming months, possibly boosted by a more restrictive credit market, poses a risk to the trajectory of revenues in 2023. On the expenditure side, the expenditures created with EC No. 126 are also a risk, considering the lack of clarity regarding the financing sources and the potential impact of the measures announced in January by the Ministry of Finance. How these expenses will be accommodated, and the expected announcement of a new fiscal anchor may influence the credibility of the country's fiscal regime.

GRAPH 19. EVOLUTION OVER 12 MONTHS OF PRIMARY BALANCE AND RECURRENT PRIMARY BALANCE OF THE CENTRAL GOVERNMENT (R$ BILLION AT FEBRUARY 2023 PRICES)



Source: National Treasury Secretariat, Siga Brasil, and Tesouro Gerencial. Prepared by: IFI.

2.4 Evolution of public sector indebtedness indicators

Gross debt is expected to end 2023 at 78.6% of GDP. The IFI forecasts that the Gross General Government Debt (DBGG) will reach 78.6% of GDP in 2023, increasing to 81.6% of GDP in 2024. As discussed in RAF No. 73, of February 2023, the projected increase in gross debt supports the expected deterioration in the primary result of the consolidated public sector, which is expected to leave a surplus of 1.3% of GDP in 2022, for a deficit of 1.4% of GDP this year and another of 1.2% of GDP in 2024, in addition to the increase in the real interest rate implicit in gross debt, from 4.8% p.a., in 2022, to 6.0 % p.a. in 2023 (Table 11).

TABLE 11. PROJECTIONS FOR GROSS GENERAL GOVERNMENT DEBT IN 2023 AND 2024, IN THE BASELINE SCENARIO

Breakdown	2022	2023		2024	
		Projection Feb/23	Projection Mar/23	Projection Feb/23	Projection Mar/23
Consolidated public sector primary result	-1.2%	-1.3%	-1.4%	-1.1%	-1.2%
Nominal GDP (R$ billion)	9,915.32	10,521.09	10,512.46	11,200.85	11,198.88
GDP - growth real	2.9%	0.9%	0.9%	1.4%	1.4%
Implicit GDP deflator	8.3%	5.1%	5.1%	5.0%	5.0%
Actual implicit rate	4.8%	6.1%	6.0%	5.8%	4.9%
DBGG (% of GDP)	**72.9%**	**78.7%**	**78.6%**	**82.3%**	**81.6%**

Source: IBGE, Central Bank. Prepared by: IFI – Brazilian Independent Fiscal Institution.

Two considerations will be made in relation to the revision of projections presented in February for the current one. The first concerns the change in expectations for the primary result of the consolidated public sector, which changed from a deficit of 1.3% to 1.4% of GDP in 2023, and from a deficit of 1.1% to 1.2% of the GDP in 2024. These changes occurred as a result of the worsening projection for the central government's primary deficit for this and next year, as shown in Table 10 and previously discussed in this text.

The second consideration to be made in relation to the new gross debt projections refers to an adjustment made to the projection of the real implicit rate, which fell from 6.1% p.a. to 6.0% p.a. in 2023. For 2024, the IFI expects a real implicit rate of 4.9% p.a., against 5.8% p.a. of RAF No. 73 (February). The change in the projection of the implicit rate occurred due to an adjustment made to the curve. As explained in the February RAF, the IFI started to project the implicit rate on a monthly basis based on the expected path for the economy's base interest rate. Current values assume an implicit rate reduction from December 2023 onwards, in line with the start of the monetary easing cycle forecast by the IFI.

Based on the new debt projections, the IFI updated the exercise to measure the primary result of the public sector needed to stabilize the DBGG as a proportion of GDP at 73.1%, the indicator level in January 2023.[12] Table 12 presents the values for the required primary result based on different trajectories for real economic growth and the real interest rate implicit in gross debt.

TABLE 12. PUBLIC SECTOR PRIMARY RESULT REQUIRED TO STABILIZE GROSS DEBT AT 73.1% OF GDP

DBGG in t		DBGG Implicit Real Interest							
73.1%		0.5%	1.5%	3.0%	4.0%	4.5%	4.8%	5.4%	5.9%
Real GDP (% p.a.)	0.5%	0.0%	0.7%	1.8%	2.5%	2.9%	3.1%	3.6%	3.9%
	0.9%	-0.3%	0.4%	1.5%	2.2%	2.6%	2.8%	3.3%	3.6%
	1.4%	-0.6%	0.1%	1.2%	1.9%	2.2%	2.5%	2.9%	3.2%
	2.0%	-1.1%	-0.4%	0.7%	1.4%	1.8%	2.0%	2.4%	2.8%
	2.5%	-1.4%	-0.7%	0.4%	1.1%	1.4%	1.6%	2.1%	2.4%
	3.0%	-1.8%	-1.1%	0.0%	0.7%	1.1%	1.3%	1.7%	2.1%
	3.5%	-2.1%	-1.4%	-0.4%	0.4%	0.7%	0.9%	1.3%	1.7%

Source: Elaboration IFI.

In the medium term, the primary surplus needed to stabilize the DBGG is 1.5% of GDP. For the implicit real interest rate on gross debt at 5.9% and real economic growth of 0.9%, IFI projections for 2023, the primary surplus required to stabilize the DBGG at 73.1% of GDP would be 3.6% of GDP. For the medium term (period from 2023 to 2031), the IFI scenario forecasts average real economic growth of 1.9% and real implicit interest on the debt of 3.9% p.a., which would result in a required primary of 1. 5% to stabilize DBGG as a proportion of GDP.[13]

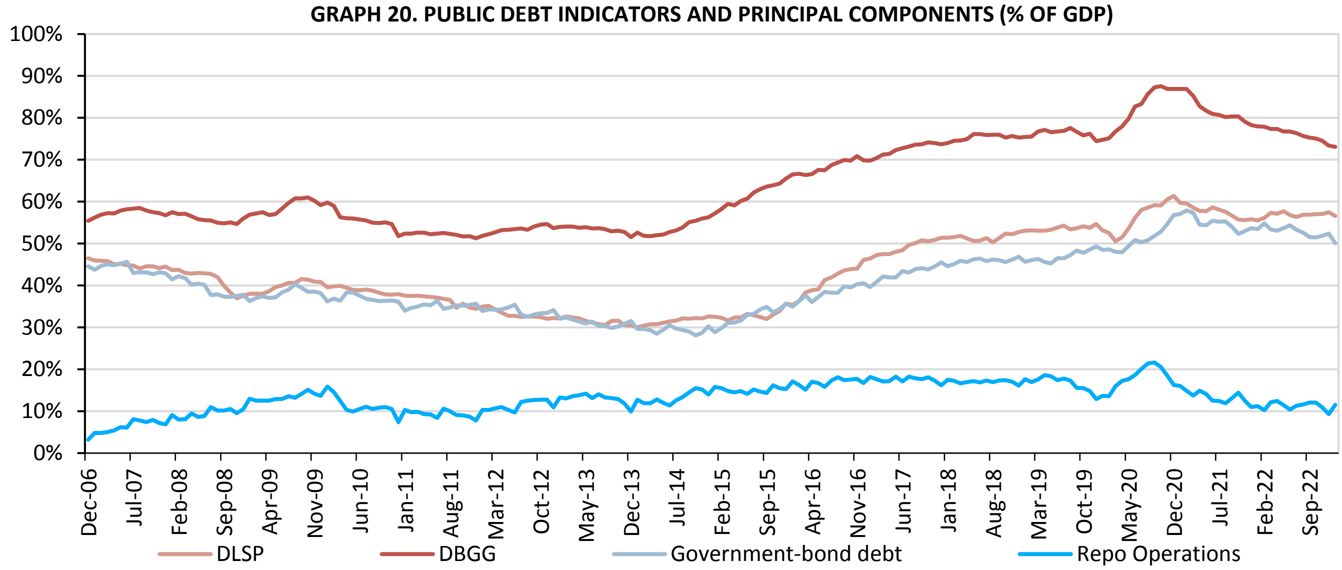
General Government Gross Debt recorded a further drop in January compared to December. According to the Central Bank, the DBGG fell by 0.3 p.p. of GDP in January, to 73.1% of GDP. There was a reduction of 4.8 p.p. compared to January 2022. Contributed to reducing the DBGG in January, nominal GDP (a drop of 0.6 p.p.), net debt redemptions (a decrease of 0.3 p.p.) and exchange rate depreciation (a drop of 0.1 p.p.). On the other hand, the appropriation of nominal interest contributed to the growth of the indicator in the period (increase of 0.7 p.p.). Graph 20 shows the trajectory of DBGG.

[12] The value of 73.1% of GDP for the DBGG in January 2023 does not consider the release of the result of the Quarterly National Accounts for the fourth quarter of 2022. This percentage was published by the Central Bank in the January fiscal statistics, at the end of February.

[13] See RAF No. 70, November 2022. Link to access the document: https://www12.senado.leg.br/ifi/publicacoes-1/relatorio/2022

Net debt fell in January compared to December, but rose compared to January 2022. The Net Public Sector Debt (DLSP), in turn, fell by 0.9 p.p. of GDP in January compared to the previous month, and rose by 1.1 p.p. of GDP compared to January 2022, reaching 56.6% of GDP (Graph 20). This movement occurred due to the primary surplus (reduction of 1.0 p.p.), nominal GDP growth (decrease of 0.5 p.p.), the variation in the parity of the basket of currencies that make up the net external debt (decrease of 0.3 p.p.), partially offset by the appreciation of the exchange rate (increase of 0.3 p.p.) and the appropriation of nominal interest (increase of 0.5 p.p.).

GRAPH 20. PUBLIC DEBT INDICATORS AND PRINCIPAL COMPONENTS (% OF GDP)



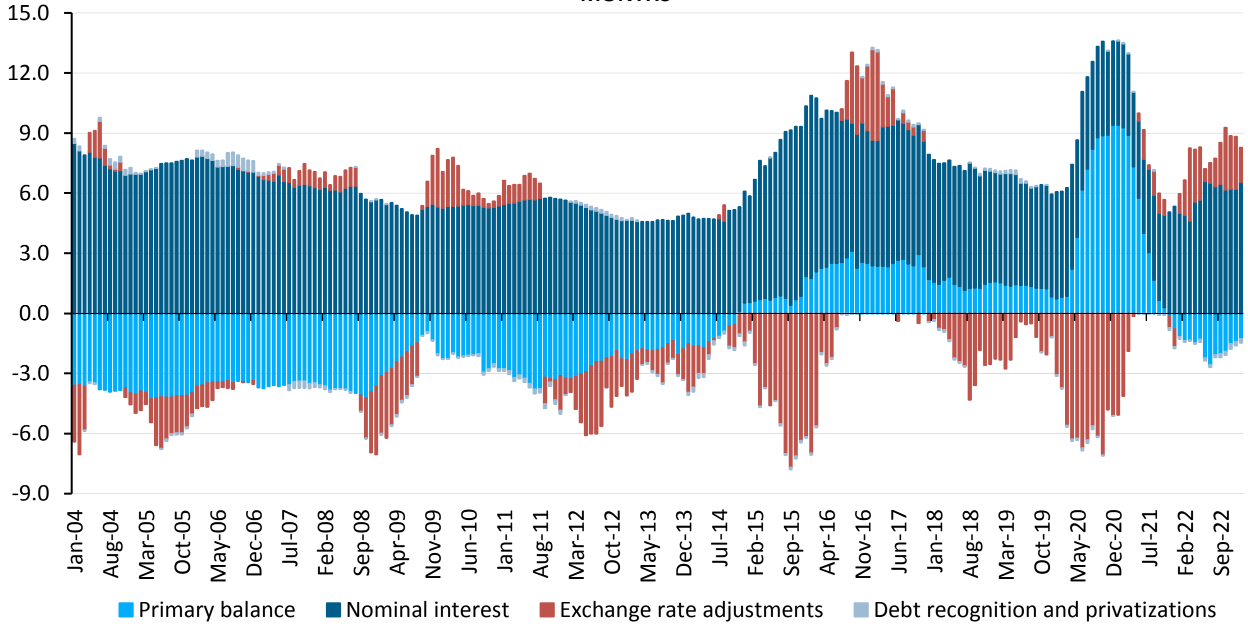
Source: Central Bank. Prepared by: IFI.

Net debt grew last year. Unlike the DBGG, which has been on a downward trajectory since 2021, the DLSP grew by 1.7 p.p. of GDP in 2022. The discrepancy verified in the recent evolution of the two debt indicators is explained by the composition and scope of the statistics. Basically, the DBGG consolidates all public sector liabilities (securities debt, external debt, internal and external bank debt of all federal entities, among others), while the DLSP encompasses liabilities minus credits (international reserves, Treasury credits with public banks, FAT resources in the banking network, equity changes, among others).[14]

Graph 21 presents information released by the Central Bank regarding the evolution of the DLSP conditioning factors: public sector primary result, interest payments, exchange rate adjustments on the balance sheet denominated in foreign currency, debt recognition and privatizations. Exchange rate adjustments consist of equity gains or losses caused by changes in the exchange rate on assets (for example, international reserves) and liabilities (for example, external debt) of the public sector in foreign currency.

[14] A more detailed explanation regarding the debt indicators can be obtained in IFI Special Study (EE) No. 7, October 2018, available at the following link: https://www2.senado.leg.br/bdsf/bitstream/handle/id/547744/EE_07_Divida_Bruta.pdf

GRAPH 21. FACTORS AFFECTING PUBLIC SECTOR NET DEBT (% OF GDP) - ACCUMULATED IN 12 MONTHS



Source: Central Bank. Prepared by: IFI.

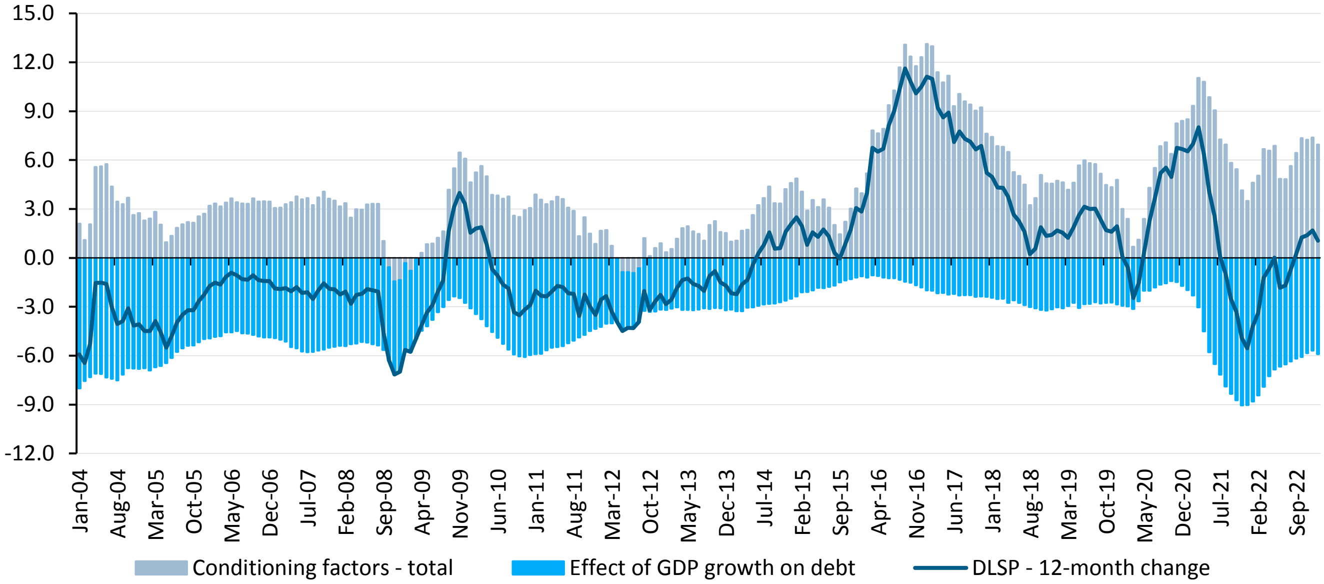
Interest expense contributed to increase DLSP by 6.5 p.p. of GDP in the 12 months ending in January. In the accumulated 12 months through January, the sum of all conditioning factors contributed to an increase of 7.0 p.p. of the GDP in the DLSP. Of this total, 6.5 p.p. resulted from the net payment of nominal interest. Exchange rate adjustments on the public sector balance sheet denominated in foreign currency accounted for 1.7 p.p. debt increase due to the exchange rate appreciation, while the recognition of debts and privatizations caused the debt to fall by 0.1 p.p. in the 12 months ending in January. The public sector primary result offset part of this increase, having contributed to a drop of 1.3 p.p. of the DLSP's GDP in this comparison.

Still in relation to Graph 21, one can see the influence of interest payments, primary results and exchange rate adjustments on the dynamics of the DLSP over time. In the most recent period, from 2021 until now, the positive primary results contributed to the reduction of the net debt, while nominal interest and exchange rate adjustments contributed to the increase in the indicator. Throughout the period considered, interest payments constitute the most representative conditioning factor for the dynamics of the DLSP.

Graph 22 consolidates all the conditioning factors and the effect of nominal GDP growth on the DLSP variation over time. The variables are considered in the accumulated sum in 12 months. The dark blue line represents the difference between the conditioning factors (as a proportion of GDP) and the effect of GDP variation. The graph makes it possible to assess how nominal GDP growth mitigates the pressures of conditioning factors, especially net interest payments, on net debt.

Increase in nominal GDP has offset part of the increase in DLSP arising from conditioning factors. While the conditioning factors of the DLSP exerted a contribution of 7.0 p.p. of GDP for the increase in the indicator in the 12 months ending in January, the increase in nominal GDP removed 5.9 p.p. of the debt, so that the DLSP variation recorded in the period was 1.1 p.p. of GDP. It is worth mentioning the decrease in this effect of nominal GDP growth on debt in recent months, as a result of the weakening of economic activity and the slowdown in price variation (inflation). Weaker economic activity therefore poses a risk to the dynamics of the DLSP in the coming months.

GRAPH 22. THE SUM OF CONDITIONING FACTORS, THE EFFECT OF THE GDP, AND VARIATION IN 12 MONTHS OF THE DLSP (% OF GDP) - ACCUMULATED IN 12 MONTHS



Source: Central Bank. Prepared by: IFI.

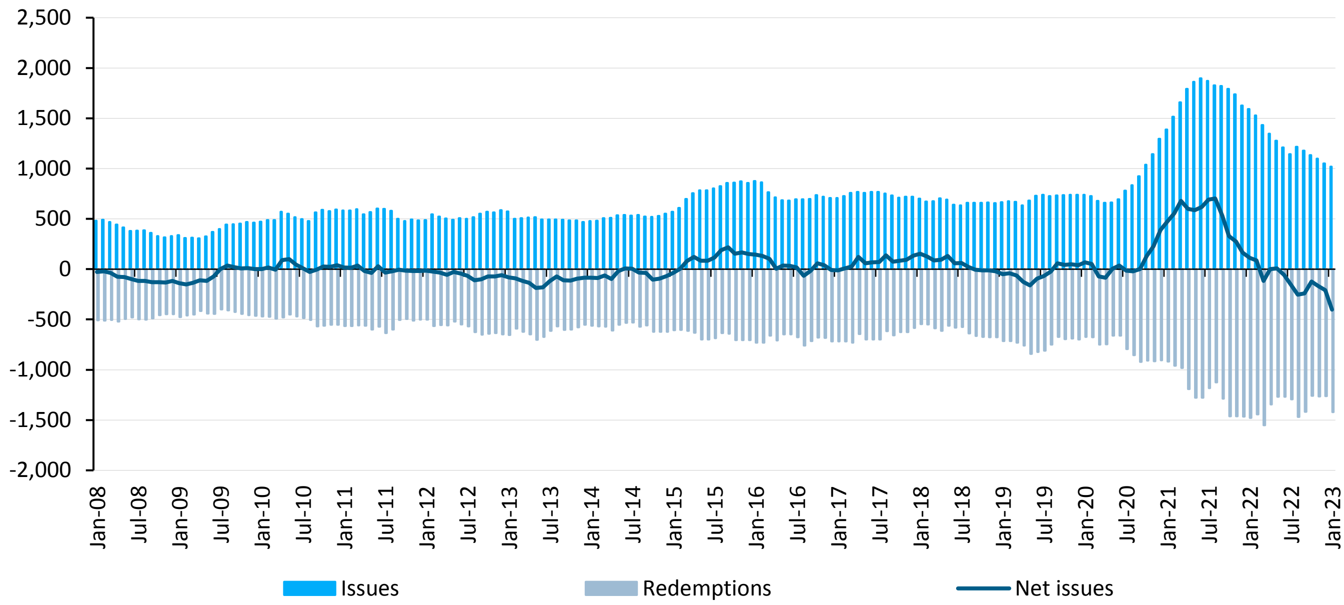
Debt redemptions carried out in January totaled R$ 315.3 billion. Some information presented in the Monthly Debt Report (RMD) is now analyzed, with data updated until January 2023. The first point to be highlighted concerns the high volume of net redemptions of the Federal Public Debt (DPF), which includes the internal and external debt, in the first month of the year, of R$ 230.7 billion. According to the Treasury, the volume of redemptions in January (R$ 315.3 billion) was the second highest in the historical series and is the highest amount of maturities expected for 2023. Maturities were concentrated in fixed-rate securities (National Treasury Bills, LTN, and National Treasury Notes series F, NTN-F).

Since the beginning of 2022, issuance volume has been below redemptions. To assess the trajectory of debt issues and redemptions, the IFI constructed Graph 23, which shows the 12-month evolution of issues, redemptions and net issues (issues minus redemptions) of the Domestic Federal Public Debt (DPMFi). In January 2023, issues totaled R$ 1,018.1 billion, while redemptions totaled R$ 1,420.0 billion in the rolling 12-months. The trajectory of the volume of issuances is downward, while redemptions show some stability. Thus, net issues, which correspond to the difference between issues and redemptions, have been on a downward trend since the beginning of 2022.

Graph 24 shows only the evolution of net DPMFi redemptions in the 12-month period, as well as the average annual volume from 2008 to 2022. It is clear that the volume of net Treasury issues is below the annual average of the last 15 years.

A possible explanation for the lower volume of issues carried out by the Treasury in the recent period lies in the increase in the average cost of debt, a topic to be explored later in this text. In effect, the monetary tightening cycle, which began in March 2021, raised the Selic from 2.00% p.a., in that month, to 13.75% p.a. in August 2022, remaining at this level ever since. With a higher issuance cost, the Treasury has made greater use of the liquidity reserve for public debt management.

GRAPH 23. ISSUES, REDEMPTIONS AND DPMFI NET ISSUES (R$ BILLION) ACCUMULATED IN 12 MONTHS



Source: National Treasury Secretariat. Prepared by: IFI.

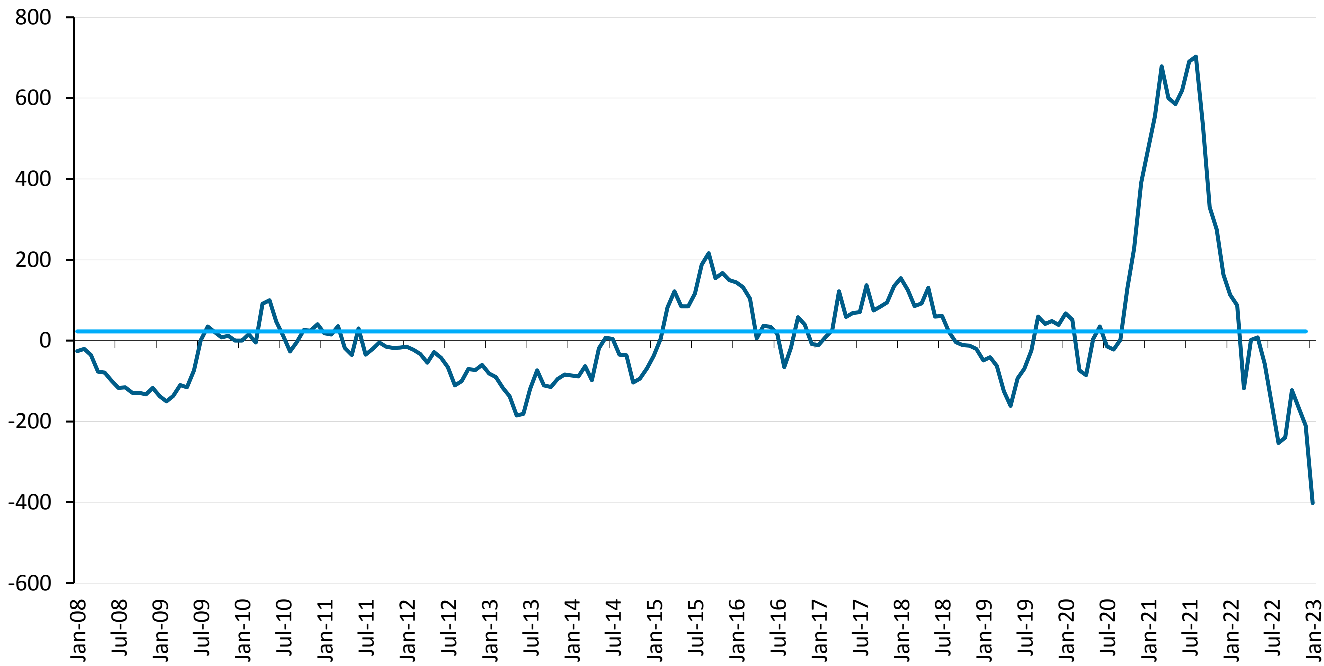
According to the STN, the public debt liquidity reserve recorded a reduction of R$ 1,175.8 billion in December, to R$ 953.4 billion in January. The reserve (or liquidity cushion) constitutes cash available exclusively for debt payment and the cash balance of resources arising from the issuance of securities. These resources are deposited in the Treasury Single Account at the Central Bank.

The Treasury also calculates a prudential value of the liquidity reserve as the amount sufficient to pay three months of debt commitments. In January, this amount was R$ 252.7 billion, against R$ 521.4 billion in December 2022.

Public debt liquidity index fell in the last two months, reaching 7.6 months. Also according to the STN, the liquidity index, which indicates the sufficiency of liquidity to cover the maturities of DPMFi securities in number of months, dropped from 9.3 months, in November, to 8.4 months, in December, and 7.6 months in January. It should be noted that the index reflects bond maturities and expected interest payments in the months ahead. In other words, if the Treasury stops making issues, current cash available is enough to honor 7.6 months of obligations.

Use of the liquidity reserve with lower issues can bring risks to public debt management. The apparent strategy of reducing emissions and using the liquidity reserve to pay Treasury obligations may represent a risk if the Selic remains at high levels for a longer period of time, as well as in a situation of increased risk perception by agents who finance the rollover of the public debt. This is because some factors that contributed to the increase in the liquidity cushion in 2022 may not be repeated this year, such as the collection of income from dividends and stakes in state-owned companies and the untying of some funds. Last year, the Union collected R$ 87.0 billion in dividends. The IFI will continue to monitor the evolution of the reserve and liquidity ratio in the coming months.

GRAPH 24. DPMFI NET ISSUES (R$ BILLION) ACCUMULATED IN 12 MONTHS



Source: National Treasury Secretariat. Prepared by: IFI.

Average cost of DPMFi issues in public offering increased again in January. Another point to highlight in relation to the January 2023 RMD concerns the trajectory of the average cost of public debt, which rose again at the margin in January. This cost decreased in the third quarter of last year due to the drop in inflation, but rose again in the last three months of the year. The IPCA and the Selic are two indexers of the Federal Public Debt (DPF). The increase in the average cost of debt stems from the relatively high Selic rate, as well as from inflation, which despite having cooled down, remains above the target.

Average bond issuance rates at auctions rose in February, especially at longer maturities. As highlighted in the January RMD, average DPMFi issuance rates rose in January. And information collected by the IFI in the auctions carried out by the Treasury indicate new increases in the rates of DPMFi bonds in February, especially in longer-term bonds.[15] By way of illustration, the fixed-rate bond maturing on October 1, 2024 had an average issuance rate of 13.15% p.a. in February, against 13.61% p.a. in January. For the fixed-rate bond maturing on January 1, 2026, the average issuance rate increased from 12.73% p.a. in January to 13.04% p.a. in February. Securities linked to price indices recorded an increase in issuance rates in the period for maturities in 2040 and 2050, while there was a decrease in maturities in 2026. Bonds (and their respective maturities) are communicated quarterly by the Treasury and may change over time.

[15] Link to access the spreadsheet: https://www12.senado.leg.br/ifi/dados/dados .

IFI Forecasts

SHORT TERM

IFI Forecasts	2023			2024		
	February	March	Comparison	February	March	Comparison
GDP - real growth (% p.a.)	0.91	0.91	▲	1.44	1.42	▼
Nominal GDP (R$ billion)	10,521.09	10,512.46	▼	11,200.85	11,198.88	▼
IPCA – acumm. (% in the year)	5.59	5.59	▼	3.80	3.92	▲
Exchange rate - end-of-period (BRL/USD)	5.24	5.25	▲	5.30	5.32	▲
Employment - growth (%)	0.71	0.73	▲	0.79	0.79	▲
Payroll - growth (%)	0.89	4.26	▲	1.58	1.42	▼
Selic - end of period (% a.a.)	13.00	13.00	=	10.00	10.00	=
Ex-ante real interest (% p.a.)	6.09	5.95	▼	3.86	5.29	▲
Consolidated Public Sector Primary Balance (% of GDP)	–1.32	–1.39	▼	–1.07	–1.18	▼
of which Central Government	–1.12	–1.19	▼	–0.87	–0.98	▼
Net nominal interest rate (% of GDP)	6.63	6.63	▲	7.56	6.48	▼
Nominal Result (% of GDP)	–7.95	–8.02	▼	–8.63	–7.65	▲
General Government Gross Debt (% of GDP)	78.74	78.57	▼	82.30	81.95	▼

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