Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

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HIGHLIGHTS

- GDP projection for 2023 revised from 2.3% to 3.0%.
- Expected growth for 2024 remains at 1.2%.
- The Executive's managed revenue projection for 2024 is higher than the IFI's by 1.8 p.p. of GDP.
- Measures included in the PLOA 2024 could produce a revenue gain of R$ 276.4 billion.
- Legal disputes represent a relevant risk factor for the materialization of revenues in 2024.
- Expenses included in the 2024 PLOA are the highest in the historical series, and amount to R$401 billion for 2024.
- The risk of not meeting the primary balance target is classified as high by the IFI.
- General government gross debt is expected to reach 75.8% of GDP in 2023.
- The primary balance needed to stabilize gross debt at 75.8% is 1.3% of GDP.
- The probability of DBGG exceeding 90% of GDP by 2027 has risen to 18.2%.

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Fiscal anchoring and the budget proposal for 2024

The Fiscal Follow-up Report (RAF) is the IFI's monthly conjuncture analysis and meets the purposes in Art. 1 of Federal Senate Resolution No. 42 of 2016. It is through the RAF that the projections for the main macroeconomic and fiscal variables of the Brazilian economy are published.

This edition comes out at a time when the National Congress is analyzing the 2024 Annual Budget Bill (PLOA 2024), the first budget based on the provisions of Complementary Law No. 200 of 2023, which established the Sustainable Fiscal Regime (RFS) to function as a new fiscal anchor to replace the current "New Fiscal Regime" instituted at the end of 2016 by Constitutional Amendment No. 95, known as the expenditure ceiling. The discussions within Congress are unfolding with a starting point of a fiscal imbalance scenario, indicated by persistent primary deficits between 2014 and 2021, except a small surplus of 0.5% of GDP in 2022, and a return to a deficit situation in 2023, projected by the IFI at 1.0% of GDP

The RFS, which underpinned the construction of the budget proposal for 2024, shifts the axis of fiscal adjustment away from expenditure control, a predominant feature of the now-defunct expenditure ceiling, towards increasing public revenues, mainly due to the primary balance target set at 0% of GDP in the 2024 Budget Guidelines Bill (PLDO 2024).

In the macroeconomic context, the revisions made to economic growth in 2023 stand out, especially after the release of the second quarter GDP, which was predominantly higher than expected. As a result, the GDP projected by the IFI for 2023 has been revised to 3%, with the growth outlook for 2024 remaining at 1.2%. Regarding the 2024 scenario, it is noteworthy that the budget proposal presented by the Executive branch last month projects a more optimistic scenario, with a growth rate of 2.3%, significantly higher than what was expected by the IFI and the market consensus. (Página 4).

On the public expenditure side, the volume of earmarked funds highlighted in the budget presented by the Executive is emphasized. There are three conditioning factors in total: (i) BRL 32.4 billion expands the limit of primary expenditures subject to the expenditure ceiling, due to the inflation differential between June and December (estimated), used to calculate the 2024 ceiling;(ii) BRL 168.5 billion are conditioned upon the approval of measures to increase primary revenues; and (iii) BRL 200.2 billion are conditioned upon Congress's approval, by an absolute majority, of a constitutional provision for non-compliance with the golden rule (Página 9).

Having made these considerations, RAF 80 shows that the achievement of the zero primary balance target in 2024, provided for in the "sustainable fiscal regime" and the PLOA 2024, is strongly conditioned to the materialization of a series of revenues derived from legal initiatives proposed by the Executive Branch and under analysis by the National Congress (taxation on investment subsidies, fixed-odds sports betting, financial assets held by individuals abroad, stock and flow of closed-end funds, end of deductibility of interest on equity, recovery of credits within the scope of CARF). With these measures, the Federal Government expects an increase in primary revenue equivalent to BRL 168.5 billion. As the adjustment measures are still subject to parliamentary deliberation and some are highly likely to be challenged in the courts, the desired fiscal balance remains shrouded in enormous uncertainty. In this context, the IFI's estimate for the 2024 primary deficit is 1.0% of GDP (Página 14).

Given the framework analyzed in RAF 80, involving multiple macroeconomic and fiscal aspects for 2024, the scenario envisioned by the IFI does not indicate stabilization of public debt as a proportion of GDP (Página 19).

Only after the approval by the National Congress of the set of revenue-increasing measures, the 2024 Budgetary Guidelines Bill (PLDO), the 2024 Budgetary Law (PLOA), and the observation of the degree of litigation aroused, will it be possible to have more accurate view of the prospects for public finances and a potential reduction in the short-term risk of non-compliance with fiscal rules.

The current scenario is characterized by multiple uncertainties.

Happy reading!

Marcus Pestana
IFI Executive Director

Vilma da Conceição Pinto
IFI Director

GDP projection for 2024 maintained at 1.2%

Rafael Bacciotti

The GDP result for the second quarter exceeded expectations. However, the data for July and August indicate that economic activity continued to slow down in the third quarter, with a possible stability compared to the previous one. As a result, the IFI revised its 2023 GDP projection from 2.3% to 3.0%. It's worth noting that the low statistical carryover projected for the next year makes the growth outlook more challenging. The projection for GDP growth in 2024 was maintained at 1.2%.

After a 1.8% growth in the first quarter of 2023, the Gross Domestic Product (GDP) advanced by 0.9% in the second quarter of the same year compared to the previous quarter, in the seasonally adjusted series. Compared to the same period in 2022, GDP increased by 3.4%, slowing down compared to the 4.0% growth seen in the first quarter of this year. Considering the positive performance in the second quarter, the projected carryover for 2023 is 3.1%. Therefore, if it remains unchanged in the third and fourth quarters, the GDP would end the year with an increase of 3.1%, a variation close to that recorded in 2022, which was 2.9%

TABLE 1. GDP GROWTH RATES IN VOLUME

	% change compared to the same quarter of the previous year			% change compared to the previous quarter (seasonally adjusted)			Year-to-date % change		
	Dec-22	Mar-23	Jun-23	Dec-22	Mar-23	Jun-23	2020	2021	2022
PIB	1.9	4.0	3.4	0.1	1.8	0.9	-3.3	5.0	2.9
Supply-side perspective									
Agriculture	-2.9	18.8	17.0	-1.3	21.0	-0.9	4.2	0.3	-1.7
Industry	2.6	1.9	1.5	-0.2	0.1	0.9	-3.0	4.8	1.6
Services	3.3	2.9	2.3	0.2	0.6	0.6	-3.7	5.2	4.2
Demand-side perspective									
Household consumption	4.3	3.5	3.0	0.4	0.7	0.9	-4.6	3.7	4.3
Government consumption	0.5	1.2	2.9	0.3	0.4	0.7	-3.7	3.5	1.5
Gross fixed capital formation	3.5	0.8	-2.6	-1.2	-3.4	0.1	-1.7	16.5	0.9
Exports	11.7	7.0	12.1	3.5	0.3	2.9	-2.3	5.9	5.5
Imports	4.6	2.2	2.1	-3.7	-3.9	4.5	-9.5	12.0	0.8

Source: IBGE.

Despite the slowdown observed in the transition from the first to the second quarter, economic activity surprised positively, exceeding expectations. The Independent Fiscal Institution (IFI) had projected variations of 2.8% compared to the same period last year and 0.4% compared to the previous quarter. In addition, the GDP result for the second quarter exceeded the average forecast of the Focus Bulletin of the week before the release of the Quarterly National Accounts, which were 2.5% and 0.1%. It was also higher than the result of the Central Bank's Economic Activity Index (IBC-Br), an aggregate indicator that monitors economic activity monthly and is calculated based on agricultural, industrial, and service production. The IBC-Br for the second quarter of 2023 registered growth of 2.6% compared to the same period last year and 0.4% compared to the previous quarter.

From a production perspective, GDP growth at the margin was driven by expansions of 0.9% in the industrial sector and 0.6% in the services sector, which offset the 0.9% drop in the agricultural sector. The highlight in the industrial sector was the positive performance of the extractive industry, which recorded an increase of 1.8% in the period due to the increase in the extraction of oil, gas, and ferrous ores. In the services sector, the components of financial intermediation and insurance stood out with a growth of 1.3%. The drop in agriculture, on the other hand, was mainly attributed to the end of the soy harvest period.

From a demand perspective, growth in the period was well distributed among the different components, with an emphasis on the 0.9% increase in household consumption. In addition, government consumption and gross fixed capital formation grew by 0.7% and 0.1% respectively. Concerning foreign trade, exports and imports increased, with growth rates of 2.9% and 4.5%, respectively.

TABLE 2. CONTRIBUTIONS (IN P.P.) FOR THE RATE (YOY) OF GDP (P.P.)

	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
PIB	**2.4**	**3.7**	**3.6**	**1.9**	**4.0**	**3.4**
Internal absorption	**-1.0**	**4.5**	**3.9**	**0.6**	**3.1**	**1.3**
Household consumption	1.5	3.3	2.8	2.8	2.2	1.8
Government consumption	0.6	0.2	0.2	0.1	0.2	0.5
Gross fixed capital formation	-1.2	0.3	1.0	0.6	0.1	-0.5
Change in stocks	-1.9	0.7	-0.1	-2.9	0.5	-0.6
Net exports	**3.4**	**-0.8**	**-0.3**	**1.3**	**0.9**	**2.1**

Source: IFI.

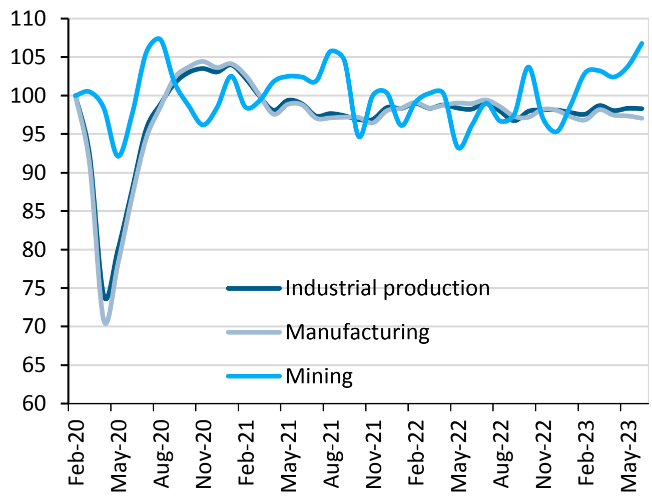
According to IFI calculations, domestic absorption, which comprises total spending on consumption and investments, slowed down in the transition from the first to the second quarter. The contribution to the year-on-year change in GDP went from 3.1 to 1.3 percentage points (p.p.), as shown in Table 2. Among the various components, the contributions to this variation came from household consumption (1.8 p.p.), government consumption (0.5 p.p.), gross fixed capital formation (-0.5 p.p.), and changes in inventories (-0.6 p.p.). In addition, net exports had a positive impact of 2.1 p.p. on the GDP result, as exports outperformed imports in the year-on-year comparison.

The increase in labor income and fiscal stimulus measures, especially the adjustment in the *Bolsa Família* [Family Allowance] program, are factors that help boost domestic consumption, reducing the contractionary impact on economic activity resulting from the high basic interest rate. Investments, in this sense, may be responding to the contractionary stance of monetary policy. It is important to highlight, however, that the main driver for GDP growth in the second quarter was the external sector, mainly due to the significant expansion in the quantity of goods exported, especially agricultural and extractive industry products.

The known economic activity data for the third quarter of 2023 indicates a slowdown with relatively stable GDP at the margin. The IFI's projection for the GDP for the period is a growth of 2.5% compared to the same period of the previous year and 0.1% compared to the previous quarter.

In July, industrial production fell by 0.6%, with a year-on-year variation of -1.1%. This decline in the sector's activity can be attributed to decreases in the manufacturing industry (-0.4%) and the extractive industry (-1.4%). In August, the indicators for the industrial sector showed mixed results. While the Capacity Utilization Rate (Nuci) in the manufacturing industry declined, heavy vehicle traffic on the roads, according to the Brazilian Association of Highway Concessionaires (ABCR), has once again increased. Consumer and business confidence indices also rose in this period, except for the industrial and services sectors.

GRAPH 1. INDUSTRIAL PRODUCTION (FEB/2020 = 100 SEASONALLY ADJUSTED)



Source: IBGE.

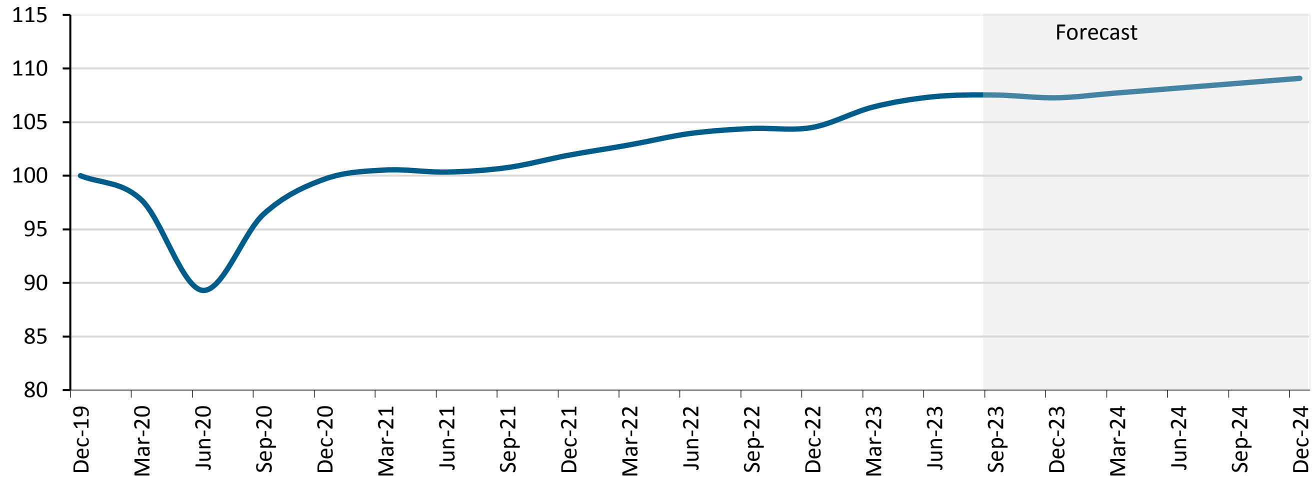
TABLE 3. GDP GROWTH IN 2023 FOR DIFFERENT QUARTERLY VARIATIONS

	Q1 and Q2: 1.9% and 0.9%				
	Hypothesis for the 3Q variation				
Hypothesis for the average variation in Q3 and Q4		**-0.5%**	**0.0%**	**0.5%**	**1.0%**
	-1.0%	2.6%	2.8%	3.1%	3.3%
	-0.5%	2.7%	3.0%	3.2%	3.5%
	0.0%	2.8%	3.1%	3.3%	3.6%
	0.5%	3.0%	3.2%	3.5%	3.7%

Source: IFI.

Table 3 shows various growth estimates for GDP in 2023, calculated based on different scenarios for the third and fourth quarters. If we imagine that economic activity remains stable until the end of the year, GDP growth in 2023 would be 3.1%, exactly equal to the value of the statistical carryover. The good performance seen in the second quarter led to an upward revision in the IFI's projection for a positive variation in 2023, from 2.3% to 3.0%. This adjustment translates into an estimated quarterly increase of 0.1% in the third quarter and a decrease of -0.2% in the fourth quarter, compared to the immediately preceding period.

GRAPH 2. GDP - QUARTERLY VOLUME INDEX (DEC/2019= 100 SEASONALLY ADJUSTED)



Source: IBGE and IFI.

The scenario envisaged for 2024 is characterized by a still high degree of uncertainty. The expectation of a relatively low statistical carryover from 2023 to 2024, estimated at 0.1%, makes the growth outlook more challenging. This has led the IFI to maintain its projection for a positive variation in GDP in 2024 at 1.2%. The average underlying quarterly growth rate is 0.4%, as illustrated in Graph 2.

The IFI's forecast for real GDP growth in 2023 and 2024 is obtained through the analysis of components from the expenditure perspective, detailed in Table 4. Based on the estimates for aggregate demand items, the contributions of domestic demand and the external sector to GDP growth in 2024 are estimated at 1.6 p.p. and -0.3 p.p., respectively.

The relative stability of domestic demand's contribution to the increase in 2024 is mainly the result of the expected slowdown in the household consumption expenditure component (from 2.6% to 1.6%). This decrease reflects the expectation of a slower pace of expansion of real wages in the labor market and income transfers, despite the policy of real readjustment of the minimum wage.

TABLE 4. FORECASTS FOR GDP GROWTH IN VOLUME

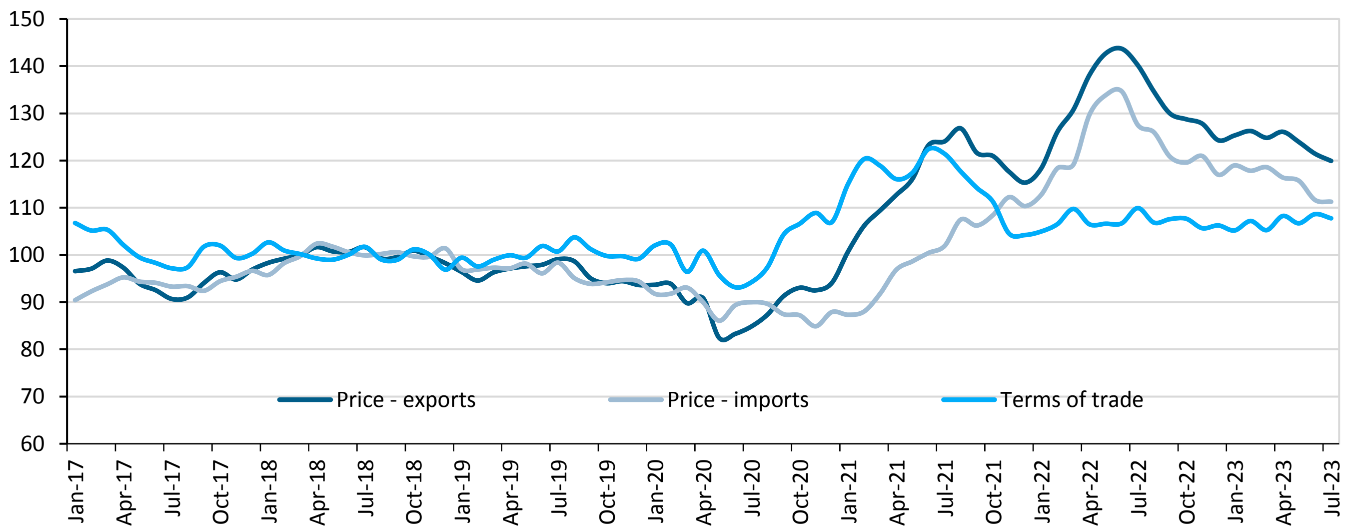
	2022	2023	2024
GDP and components (real % variation)	**2.9**	**3.0**	**1.2**
Household consumption	4.3	2.6	1.6
Government consumption	1.5	1.8	1.2
Gross Fixed Capital Formation	0.9	-1.0	2.0
Export	5.5	6.0	2.0
Import	0.8	0.5	3.5
Contributions to the real variation in GDP (p.p.)			
Internal demand	**2.0**	**1.9**	**1.4**
Household Consumption	2.6	1.7	1.0
Government consumption	0.3	0.4	0.2
Investment (GFCF and change in inventories)	-0.9	-0.1	0.2
Net exports	**0.9**	**1.0**	**-0.3**

Source: IBGE and IFI.

In the external sector, economic growth in the main trading partners[1], weighted by the share of trade with Brazil, is expected to decline in the transition from 2023 to 2024. This will probably result in a reduction in the strength of exports.

The monthly volume indices published up to July indicate a trend of stability in imports and a still very positive dynamic in exports. At the same time, price indices for imports and exports have shown a similar downward trajectory. This translates into stability in terms of trade (Graph 3), which represents the relationship between the prices of the country's exports and its imports. The expected slowdown in demand from the main partners and the stabilization of the terms of trade are vectors that could limit economic growth.

GRAPH 3. TERMS OF TRADE (2008 = 100)



Source: Ipeadata.

According to the Executive Branch's macroeconomic scenario adopted in the preparation of the Annual Budget Bill (PLOA), GDP in volume is expected to grow by 2.3% in 2024 and to maintain an average growth rate of 2.6% from 2025 to 2027. Market projections, as reflected in the Focus Bulletin, continue to be more conservative, although there has been

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[1] Taken from the International Monetary Fund's (IMF) *Word Economic Outlook* Report.

an upward movement in recent weeks. The IFI's projections are also more modest, with growth forecasts of 1.2% and 2.0%.

In the PLOA, the projections are not broken down by GDP component, which would allow for a more detailed analysis of the assumptions and main differences. However, in the July MacroFiscal Bulletin, the Secretariat for Economic Policy (SPE) attributes the projected growth for 2024 to several factors, including i) the reduction in interest rates; ii) the improvement in the business environment, and the reduction in uncertainties with the approval of the fiscal and tax reforms; and iii) the impact on aggregate demand of the new Growth Acceleration Program (PAC), the policy of increasing the minimum wage, the new *Bolsa Família* and the *Minha Casa Minha Vida* [My House My Life, a social housing program].

Regarding consumer inflation as measured by the IPCA, the government expects a faster convergence towards the center of the target set by the National Monetary Council, which is 3.0%. Regarding the Selic rate, there is a greater divergence in the medium-term level between the projections, while the exchange rate projections are closer across different scenarios.

TABLE 5. MACROECONOMIC PROJECTIONS: PLOA, FOCUS AND IFI

	PLOA			Focus Bulletin			IFI		
	2023	2024	2025-2027	2023	2024	2025-2027	2023	2024	2025-2027
GDP - Real rate of change (%)	2.5	2.3	2.6	2.6	1.5	2.0	3.0	1.2	2.0
IPCA (% year-on-year variation in December)	4.9	3.3	3.0	4.9	3.9	3.5	5.1	3.8	3.3
BRL/US$ exchange rate (average)	5.0	5.0	5.2	5.0	5.0	5.2	5.0	5.1	5.2
Selic (average annual %)	13.1	9.8	7.3	13.3	9.8	8.5	13.3	10.0	7.8

Source: PLOA, Focus Bulletin and IFI.

The 2024 Budget Bill (PLOA 2024) includes optimistic revenue projections for the government

Alexandre Andrade and Marcus Pestana

The 2024 budget bill contains optimistic projections for central government revenues next year. Out of the potential impact of BRL 276.4 billion from measures outlined in the PLOA, BRL 69.7 billion depends on approval from Congress. In addition to the possibility of changes in the proposals currently under consideration in the Legislature, there is also the prospect of legal challenges and the continuation of disputes in the courts between taxpayers and the federal government regarding the collection of federal taxes. This risk imposes the need for caution when drawing up revenue projections for the coming years.

This analysis aims to make a prospective assessment of the Federal Government's primary revenues in 2024 within the scope of the 2024 Annual Budget Bill (PLOA 2024) to highlight the risks associated with the figures presented. As a counterpoint, updated projections for the primary revenues of the central government in 2023 and 2024 are also presented by the IFI.

Next year's budget was built based on the new fiscal framework[2]. According to the design of the new rule, achieving primary surpluses by the central government in the coming years will depend on increases in primary revenues, which poses a challenge for the Executive branch depending on the intended primary balance targets. In the 2024 Budget Guidelines Bill (PLDO 2024), the government has set a zero primary balance target for next year. Considering the scenarios outlined for economic growth by the National Treasury[3], by the analysts participating in the Central Bank's Focus Bulletin, and by the IFI, there will be a need for additional primary revenue to meet the fiscal target set for 2024.

Table 6 shows the revenue projections contained in the PLOA 2024 and the new figures calculated by the IFI based on the updated macroeconomic scenario discussed in the previous section. The main differences largely relate to the estimates for revenues collected by the Federal Revenue Office and, to a lesser extent, to revenue-sharing transfers in 2024. In revenues collected by the RFB, the deviation between the Executive's projections (PLOA 2024) and the IFI is BRL 212.1 billion, equivalent to 1.8 p.p. of GDP.

As for transfers to sub-national entities, the discrepancy between the PLOA and IFI estimates is BRL 27.5 billion (0.2 p.p. of GDP). As will be explained below, the main explanation for the difference lies in the collections expected by the Executive branch for Corporate Income Tax (IRPJ).

The differences between the government's and the IFI's estimates for administered revenue produce a deviation of 1.8 p.p. of GDP (or BRL 219.8 billion) in the projection of the central government's total primary revenue in 2024. Taking into account the deviation in transfer projections, the primary net revenue estimated by the IFI is 1.6 percentage points of GDP (BRL 192.3 billion) below the government's estimate in the budget bill.

[2] For further explanations, see IFI Technical Note No. 52 of June 2023. Page to access the document: https://www12.senado.leg.br/ifi/notas-tecnicas-ifi.
[3] Access page for the Fiscal Projections Report for the first half of 2023: https: //www.tesourotransparente.gov.br/publicacoes/relatorio-de-projecoes-fiscais/2023/20.

TABLE 6. CENTRAL GOVERNMENT PRIMARY REVENUE PROJECTIONS FOR 2023 AND 2024 - EXECUTIVE BRANCH AND IFI

Breakdown	2023 Projections				2024 Projections				Difference between government and IFI (p.p. of GDP)	
	3rd bimester assessment		IFI		PLOA 2024		IFI			
	BRL billion	% of GDP	BRL billion	% of GDP	BRL billion	% of GDP	BRL billion	% of GDP	2023	2024
Total primary revenue	**2,366.3**	**22.1%**	**2,342.2**	**21.9%**	**2,709.5**	**23.7%**	**2,489.7**	**21.9%**	**0.2**	**1.8**
Revenue collected by the RFB	1,474.5	13.8%	1,454.7	13.6%	1,758.8	15.4%	1,546.6	13.6%	0.2	1.8
Tax incentives	-0.1	0.0%	-0.1	0.0%	-0.1	0.0%	0.0	0.0%	0.0	0.0
Net collection for the RGPS	584.1	5.5%	585.4	5.5%	632.4	5.5%	620.6	5.5%	0.0	0.0
Other revenues (non-administered revenues)	307.8	2.9%	302.2	2.8%	318.4	2.8%	322.5	2.8%	0.1	0.0
Revenue-sharing transfers	**457.1**	**4.3%**	**454.5**	**4.2%**	**518.3**	**4.5%**	**490.8**	**4.3%**	**0.1**	**0.2**
Net revenue	**1,909.3**	**17.8%**	**1,887.7**	**17.6%**	**2,191.2**	**19.2%**	**1,998.9**	**17.6%**	**0.2**	**1.6**

Source: Executive Branch and IFI. Prepared by: IFI.

Table 7 contains a list of the measures included by the Executive branch in the PLOA 2024 to increase revenue. Of the propositions listed in the table, the Executive did not include in the official projections the revenues derived from the collection of Corporate Income Tax (IRPJ) and Social Contribution on Net Profits (CSLL) on transfer pricing.[4] The table also shows the amounts considered by the IFI for each of the measures included in the PLOA, based on the feasibility perceived at the moment of the materialization of these additional revenues.

In the 2024 Budget Proposal (PLOA 2024), the Executive expects to collect BRL 69.7 billion from measures under consideration in the Legislature, plus BRL 97.9 billion from the return of the casting vote at the Administrative Council for Tax Appeals (Carf), a matter awaiting presidential approval, totaling BRL 168.5 billion. Of this total, 79.1% of the additional revenues are concentrated in the possibility of collecting IRPJ, CSLL, PIS, and Cofins on subsidies received by companies in the context of ICMS by the states (BRL 35.3 billion) and in the recovery of tax credits in disputes at the Carf, an administrative body of the Ministry of Finance with the authority to adjudicate disputes in tax and customs matters (BRL 97.9 billion). To enable the collection of federal taxes on ICMS tax incentives, the Executive branch issued Provisional Measure No. 1,185 on August 30, 2023. The change in rules regarding the casting vote at the Carf is included in Bill No. 2,384 of 2023, approved in both houses of Congress and awaiting presidential sanction.

Other relevant sources of revenue in 2024 outlined in the PLOA and pending legislative approval include the collection of income tax on closed-end fund income (BRL 13.3 billion) and financial assets held abroad (BRL 7.0 billion), as well as the end of the deductibility of interest on equity (BRL 10.4 billion).

In addition to these sources, the Executive has listed in the PLOA measures associated with legislative proposals that have already been approved or sanctioned, such as (i) the return of full PIS and Cofins taxation on fuels (BRL 30 billion); (ii) the possibility of collecting PIS and Cofins on ICMS tax credits (BRL 57.9 billion); and (iii) the collection of Corporate Income Tax and Social Contribution on Net Profits on transfer pricing transactions (BRL 20.0 billion). This last source of revenue was not considered for the revenue projections in the PLOA.

All considered, the impact on central government revenues from the measures outlined in the PLOA 2024 and listed in Table 7 could reach BRL 276.4 billion in the Executive's projections. The IFI believes that this amount is difficult to materialize due to the arguments to be explored below.

For projecting central government revenue in 2024, the IFI considers the entry of BRL 108.6 billion in the next year, taking into account sources from legislative proposals under consideration and those resulting from already sanctioned laws (Table 7).

[4] This information is contained in the presentation of the PLOA 2024 released by the executive branch.

TABLE 7. TAX MEASURES IN THE PLOA 2024 WITH AN IMPACT ON CENTRAL GOVERNMENT REVENUE

PLOA 2024				Amount considered by IFI - baseline scenario (BRL billion)
Measure	Budget impact in 2024			
	Tax	Legislative proposal	Total (BRL billion)	
Total [1+2+3]			**276.4**	**108.6**
Legislative measures [1+2]			**168.5**	**51.9**
Revenue collected by the Federal Revenue Office (RFB) [1]			**167.6**	**51.0**
Investment grants	IRPJ, CSLL, PIS/Cofins	Provisional Measure No. 1.185, of 2023	35.3	3.5
Fixed-odds betting	Income tax and other revenues collected by RFB	Provisional Measure No. 1.182, of 2023	0.7	0.7
New simplified taxation regime (RTS)	Import tax	RFB Normative Instruction 2.146, of June 29, 2023	2.9	2.9
Closed-end funds - stock and flow	Income Tax	Provisional Measure No. 1.184, of 2023	13.3	2.0
Individual CFCs and taxation of financial assets held abroad by individuals*(offshores)*	Income Tax	Bill No. 4.173 of 2023	7.0	1.1
End of the deductibility of interest on equity	IRPJ, CSLL	Bill No. 4.258 of 2023	10.4	10.4
Recovery of credits through Carf	Income Tax, CSLL, PIS/Cofins, IPI, social security contribution, and others	Bill No. 2.384 of 2023	97.9	30.3
Revenue collected by other bodies [2]			**0.9**	**0.9**
Fixed-odds betting lottery taxes	Control and inspection fees	Bill No. 3.626 of 2023	0.9	0.9
Other income [3]			**107.9**	**55.8**
Reoneration of fuels	PIS/Cofins	Provisional Measures No. 1.175 and No. 1.178, of 2023	30.0	30.0
Exclusion of ICMS from the calculation basis of PIS/Cofins credits	PIS/Cofins	Law no. 14.592, of May 30, 2023	57.9	5.8
Transfer prices	IR, CSLL	Law no. 14.596, of June 14, 2023	20.0	20.0

Source: PLOA 2024 and IFI. Prepared by: IFI.

In the group of measures pending legislative approval, along with the return of the qualified vote of the Federal Government in Carf, the assumptions made by the IFI indicate the possibility of generating BRL 51.9 billion in revenues for the central government. Depending on the progress of the proposals in Congress and any modifications made, this sum may be revised. Below are the explanations behind the projections considered:

(i) Investment subsidies: Of the BRL 35.3 billion announced by the Executive in the budget bill, the IFI currently considers the possibility of collecting 10% of that amount (BRL 3.5 billion). The main reason for a conservative estimate is the high possibility of legal disputes on these matters. The decision of the Superior Court of Justice (STJ) regarding the taxation of ICMS tax benefits limited the collection of IRPJ and CSLL on these transactions. For this reason, on August 30, the Executive issued Provisional Measure 1,185, intending to change the taxation of ICMS tax benefits and extend the scope set by the STJ decision. The rule could increase legal uncertainty on the subject, which reinforces the possibility of continuing disputes between the Federal Government and taxpayers[5];

(ii) Closed-end funds - stock and flow: of the sum of BRL 13.3 billion intended by the government with Provisional Measure No. 1,184 of 2023, the IFI considers, for projection purposes, the inflow of BRL 2.0 billion with the measure. The explanation lies primarily in the high potential for erosion of the tax base for

[5] For a better understanding of the issue, see: https://valor.globo.com/legislacao/noticia/2023/06/12/stj-reduz-ganho-do-governo-com-tributao-de-incentivos-de-icms.ghtml and https://www.estadao.com.br/politica/blog-do-fausto-macedo/a-medida-provisoria-11852023-e-seus-reflexos-no-panorama-tributario-nacional/.

income tax (IR) on the income of closed-end funds. In addition, Provisional Measure 1,184 makes it possible to pay income tax on the funds' stocks, which could give rise to legal disputes on the matter;

(iii) Taxation of individuals' financial assets abroad (including offshores): Bill No. 4.173 of 2023 provides for the collection of IR on financial investments, controlled entities, and trusts abroad. The Executive's expected collection with the proposal is BRL 7.0 billion in 2024. Of this amount, the IFI considers the entry of BRL 1.1 billion due to the possibility of erosion of the taxable base, and...

(iv) Recovery of credits at Carf: Bill No. 2,384 of 2023, approved by the National Congress and awaiting presidential sanction, restores the pro-Tax Administration casting vote within the scope of the Administrative Council for Tax Appeals (Carf) The Executive expects to collect BRL 97.9 billion next year with the return of the casting vote in the council. For projection purposes, the IFI considers the possibility of collections amounting to BRL 30.3 billion, approximately 10% of the judgments in favor of the Federal Government in 2018 and 2019, the two years immediately preceding the change made in the casting vote at Carf.

Also concerning Carf, the board's decisions do not constitute the last instance of judgment, and it is up to the taxpayer to dispute in court the tax credit that is upheld by the body. In the situation where the casting vote was in favor of the taxpayer, in the event of a tie, the claim would be extinguished and the possibility of collection by the Federal Government would cease to exist. With the return of the casting vote in favor of the tax authorities, in the event of a tie in the judgment, the collection is maintained, and the Federal Government can take the taxpayer to court in the event of non-payment of taxes. This credit is registered as an active debt, which can affect the government's balance sheet. The situation does not, however, lead to immediate primary revenue for the central government.

In Table 7, under the group of other revenues, the IFI considered BRL 5.8 billion in collections from PIS and Cofins on the taxation of tax credits accumulated by taxpayers when purchasing inputs. In 2017, a decision by the Federal Supreme Court (STF) removed ICMS from the PIS and Cofins tax base. Law No. 14,592, of May 30, 2023, removes ICMS from the calculation basis of federal taxes also on the acquisition of inputs, which reduces the tax credits accumulated by taxpayers[6]. For the same reasons explained in the IFI's estimate for the collection of Corporate Income Tax (IRPJ), Social Contribution on Net Profits (CSLL), PIS, and Cofins in investment subsidy transactions (the possibility of prolonged legal disputes), it was decided to maintain a relatively low entry associated with this measure outlined in the PLOA 2024.

In short, the prospect of new disputes and the possibility of continuing discussions on the legal arguments surrounding some of the sources of revenue planned by the Executive in 2024 has led the IFI to adopt a more conservative stance about the revenue estimates arising from the additional measures included in the budget bill. These estimates may be revised over time as the discussion of the proposals in both houses of the National Congress advances.

Finally, Table 8 presents an analysis of the sensitivity of revenues collected by the Federal Revenue Office to the behavior of nominal GDP and the measures intended by the Executive to increase collection next year. The budget bill considers a 6.6% increase in nominal GDP in 2024, while the IFI's projection for the increase in this variable is 6.1%. The projection included in the 2024 Budget Proposal (PLOA) for central government revenues collected by the RFB is BRL 1,758.8 billion (a 19.3% increase compared to 2023), while the IFI's estimate is BRL 1,546.6 billion (a 6.3% increase compared to 2023), resulting in a difference of BRL 212.1 billion.

[6] For a better understanding of the issue, see: https://valor.globo.com/valor-data/bolsas/brasil/noticia/2023/09/03/orcamento-de-2024-conta-com-r-58-bi-de-piscofins-apesar-de-disputa-judicial.ghtml.

TABLE 8. ANALYSIS OF THE BEHAVIOR OF CENTRAL GOVERNMENT REVENUES COLLECTED BY THE RFB IN RELATION TO GDP AND THE MEASURES OUTLINED IN THE PLOA 2024

Variable	Projections				Difference between PLOA 2024 and IFI
	2023		2024		
	3rd bimester assessment	IFI	PLOA 2024	IFI	
Nominal GDP (% change)	8.1%	7.9%	6.6%	6.1%	0.5
Revenues collected by the RFB (BRL billion)	1,474.5	1,454.7	1,758.8	1,546.6	212.1
Revenues collected by the RFB (% change)	6.1%	4.7%	19.3%	6.3%	13.0
Revenues collected by the RFB without the PLOA 2024 collection measures (R$ billion)	1,474.5	1,454.7	1,482.4	1,438.0	44.3
Revenues collected by the RFB without measures (% change)	6.1%	4.7%	0.5%	-1.1%	1.7

Source: PLOA 2024 and IFI. Prepared by: IFI.

As presented in Table 7, legislative measures under consideration and other sources of revenue could increase revenues collected by the RFB by BRL 276.4 billion according to the Executive's projections. The IFI, on the other hand, estimates a potential impact of BRL 108.6 billion with the same measures, which is BRL 167.8 billion less.

Excluding the amounts from these measures, according to the calculations made by the government, the revenue collected for the central government by the Federal Revenue Office in 2024 would decrease to BRL 1,482.4 billion (an increase of 0.5% compared to 2023), while the same revenue calculated by the IFI would be BRL 1,438.0 billion (a decrease of 1.1% compared to 2023). Now, the difference between the Executive and IFI projections would be BRL 44.3 billion, which could be attributed to the government's more optimistic projection for nominal GDP in 2024 (Table 8).

In other words, the figures presented in Table 8 show the importance of the measures contained in the budget bill for achieving more favorable figures in revenues collected by the RFB in 2024. As mentioned earlier, there are risks to achieving this scenario, and the probability of revenue shortfalls is not insignificant in the IFI's assessment. The circumstances associated with the new fiscal rule, which places a heavy burden on revenues to meet fiscal targets, impose a very big challenge on the Executive in the coming months. The IFI will continue to evaluate the prospective revenue scenario, in compliance with one of its prerogatives of Federal Senate Resolution 42 of 2016.

Uncertainties and risks surrounding 2024 Annual Budget Bill

Vilma Pinto

The PLOA 2024 was presented according to the deadlines outlined in the budget planning, although with some unresolved issues. To make it possible to send the Budget Bill in compliance with the guidelines outlined in the PLDO and the rule outlined in Complementary Law 200 of 2023, the government presented it with approximately BRL 400 billion in resources subject to various conditions. These conditional expenditures, which include both primary and financial spending, bring uncertainties surrounding the feasibility of complying with fiscal rules and shed light on the various budgetary challenges that will be faced in the coming months.

At the end of August, the Executive Branch sent Congress the 2024 Annual Budget Bill[7]. The biggest challenge next year will be meeting the primary balance target. The growth in real terms of primary expenses subject to the new expenditure ceiling, established by Complementary Law (LC) No. 200 of 2023[8], the slowdown observed in primary revenues, and the high volume of resources included in the budget in a conditional-uncertain - manner, impact the perception of risk regarding compliance with the target. The scenario for the rule, despite having improved with the release of the budget bill, still maintains a high degree of uncertainty, above all due to the risk that the measures that anchor the bill in Congress will not materialize.

When examined in detail, the PLOA 2024 provides relevant information. Starting with the parameters and projections for some expenditure items, there has been a slowdown in the official projections for spending on social security benefits under the General Regime (RGPS) due to the expected reduction in the number of benefits issued as a result of a registration review. Payroll and social security expenses, on the other hand, are expected to increase compared to what was anticipated for 2023, due to the resumption of public competitive examinations and recent salary adjustments granted to some categories Expenditure on health and education shows the effects of changes in the parameters that define their constitutional floors. However, what is most striking is the high volume of conditional expenditure in the budget.

The following topics present some of the highlights of the Federal Government's 2024 Budget Bill, especially regarding the allocation of spending.

Sustainable Fiscal Regime

The PLOA 2024 is the first budget bill prepared based on the final guidelines of the Sustainable Fiscal Regime (SFR) established by LC No. 200 of 2023. According to this new regulation, approved to replace the current expenditure ceiling, federal government primary expenses may grow, in real terms, at a rate corresponding to 70% of the real growth of primary revenues, provided that this percentage is between 0.6% and 2.5%.

According to the PLOA 2024, primary revenues subject to this correction factor showed real growth of 2.43% in the 12 months up to June 2023[9], so considering 70% of this percentage leads to the possibility of real growth in primary expenditure of 1.7%.

Still, according to the RFS, the expenses that will be subject to correction in the first year of the fiscal rule correspond to the amounts approved in the 2023 LOA plus the credits made up to the date of enactment of LC 200, i.e. up to August 30,

[7] The National Congress Bill (PLN) No. 29 of 2023, referred to in the Annual Budget Bill (PLOA) for 2024, can be consulted at: https://www.congressonacional.leg.br/materias/pesquisa/-/materia/159659.

[8] Complementary Law 200 of 2023 instituted the sustainable fiscal regime, replacing the expenditure ceiling created through Constitutional Amendment (EC) No. 95 of 2016. The LC 200 is available at: https://www.planalto.gov.br/ccivil_03/leis/lcp/Lcp200.htm.

[9] It's worth mentioning that the Sustainable Fiscal Regime (RFS) stipulates that the real growth of primary revenues subject to the rule should be calculated based on the 12-month window ending in June of the year in which the Budget Bill is submitted. In this case, the variation considers the revenues accumulated from July 2022 to June 2023 compared to the same period of the previous year, i.e. from July 2021 to June 2022.

2023. Thus, the expenses considered for setting the expenditure limit for 2024 amount to BRL 2.043 billion. Regarding this amount, the percentage change should be applied to arrive at the expenditure limit for 2024.

To provide more predictability, the RFS considers, for the calculation of the limits for the following year, the data realized up to June of the year in which the Budget Bill is submitted. However, LC 200 introduced the possibility of opening supplementary credits in situations where the difference between the calculation of the expenditure limit based on inflation in June and the same calculation based on inflation in December is positive **(art . 4, § 1, LC 200, de 2023).**

This possibility of opening a supplementary credit was estimated in the budget bill at BRL 32.4 billion, but it is still a figure that is conditional on the realization, in December 2023, of higher inflation than that seen up to June this year. In theory, the RFS does not provide for the possibility of including these expenses in the budget, and the executive branch must send a bill to supplement the expenses during the year of reference of the law. However, the executive branch presented, through an amending message, a proposal to amend the 2024 PLDO to include article 23-A[10] allowing the budget to be sent with this condition. It's worth mentioning that the maintenance of these values in the 2024 Budget Bill is contingent upon the approval of the Budget Guidelines Law (LDO) with the inclusion of this article.

Table 9, below, shows the individualized limits considering the rules set out in the New Fiscal Regime - NRF, established by EC 95 of 2016 - also known as the expenditure ceiling, and the RFS, including not only the limits relating to the application of the rule set out in LC 200 but also the expenses conditioned based on the provision in Art. 23-A of the 2024 PLDO.

TABLE 9. INDIVIDUALIZED LIMITS - NRF AND RFS (BRL MILLION AND % OF GDP)

Branch / Body	BRL million, current				% of GDP				Diff. 2024 vs. 2023	
	2021	2022	2023	2024	2021	2022	2023	2024	Δ BRL million	Δ p.p. GDP
I. Executive Branch	**1,421,604**	**1,608,481**	**1,867,414**	**1,978,911**	**15.98**	**16.22**	**17.43**	**17.33**	**111,498**	**-0.10**
Conditional expenditure (Art. 23-A PLDO)	n.a.	n.a.	n.a.	32,419	n.a.	n.a.	n.a.	0.28	n.a.	n.a.
II. Legislative Branch	**12,838**	**14,510**	**15,538**	**16,302**	**0.14**	**0.15**	**0.15**	**0.14**	**764**	**0.00**
Chamber of Deputies	6,166	6,970	7,463	7,830	0.07	0.07	0.07	0.07	367	0.00
Federal Senate	4,539	5,130	5,494	5,764	0.05	0.05	0.05	0.05	270	0.00
Federal Accounting Court	2,133	2,411	2,581	2,708	0.02	0.02	0.02	0.02	127	0.00
III. Judiciary	**44,189**	**49,947**	**53,485**	**56,113**	**0.50**	**0.50**	**0.50**	**0.49**	**2,628**	**-0.01**
Supreme Court	660	745	798	838	0.01	0.01	0.01	0.01	39	0.00
Superior Court of Justice	1,535	1,752	1,876	1,968	0.02	0.02	0.02	0.02	92	0.00
Federal Court	11,425	12,926	13,842	14,522	0.13	0.13	0.13	0.13	680	0.00
Federal Military Justice	557	630	674	708	0.01	0.01	0.01	0.01	33	0.00
Electoral Justice	7,525	8,518	9,121	9,569	0.08	0.09	0.09	0.08	448	0.00
Labor Justice	19,465	22,036	23,568	24,726	0.22	0.22	0.22	0.22	1.158	0.00
Justice of the Federal District and Territories	2,754	3,113	3,334	3,497	0.03	0.03	0.03	0.03	164	0.00
National Council of Justice	268	228	273	286	0.00	0.00	0.00	0.00	13	0.00
IV. Federal Office of the Public Defender	**559**	**632**	**677**	**710**	**0.01**	**0.01**	**0.01**	**0.01**	**33**	**0.00**
V. Federal Prosecution Office	**6,747**	**7,626**	**8,166**	**8,568**	**0.08**	**0.08**	**0.08**	**0.08**	**401**	**0.00**
Federal Prosecution Office	6,661	7,529	8,062	8,459	0.07	0.08	0.08	0.07	396	0.00
National Council of Public Prosecutors	86	97	104	109	0.00	0.00	0.00	0.00	5	0.00
VI. TOTAL	**1,485,936**	**1,681,197**	**1,945,280**	**2,060,604**	**16.70**	**16.96**	**18.15**	**18.04**	**115,324**	**-0.11**
VI.b TOTAL CONDITIONAL EXPENDITURE	**n.a.**	**n.a.**	**n.a.**	**2,093,023**	**n.a.**	**n.a.**	**n.a.**	**18.33**	**147,743**	**0.17**

Source: Tesouro Transparente [Transparent Treasury] and PLOA 2024. Prepared by: IFI.

[10] Message 393, of August 4, 2023. Available at:
https://www.camara.leg.br/internet/comissao/index/mista/orca/ldo/LDO2024/proposta/MensagemModificativa.pdf.

The 2024 Budget Bill shows that primary expenses subject to the expenditure ceiling increased by BRL 115.3 billion when compared to the limits without conditional expenses, and by BRL 147.7 billion when considering the possibility of opening a supplementary credit of BRL 32.4 billion for 2024. Another factor to be observed is that LC 200 limits budget appropriations, while EC 95 limits actual expenditures paid, including the settled outstanding liabilities[11].

This distinction between the stage of expenditure to be considered for calculating the limitation on primary expenses is important because while the NRF focuses on limiting the actual disbursements in the year, the RFS only prevents, through a restriction on the authorized amount in the LOA, that expenditures exceed a certain threshold. In this context, the risks of non-compliance with the expenditure limitation rule are much lower compared to the NRF.

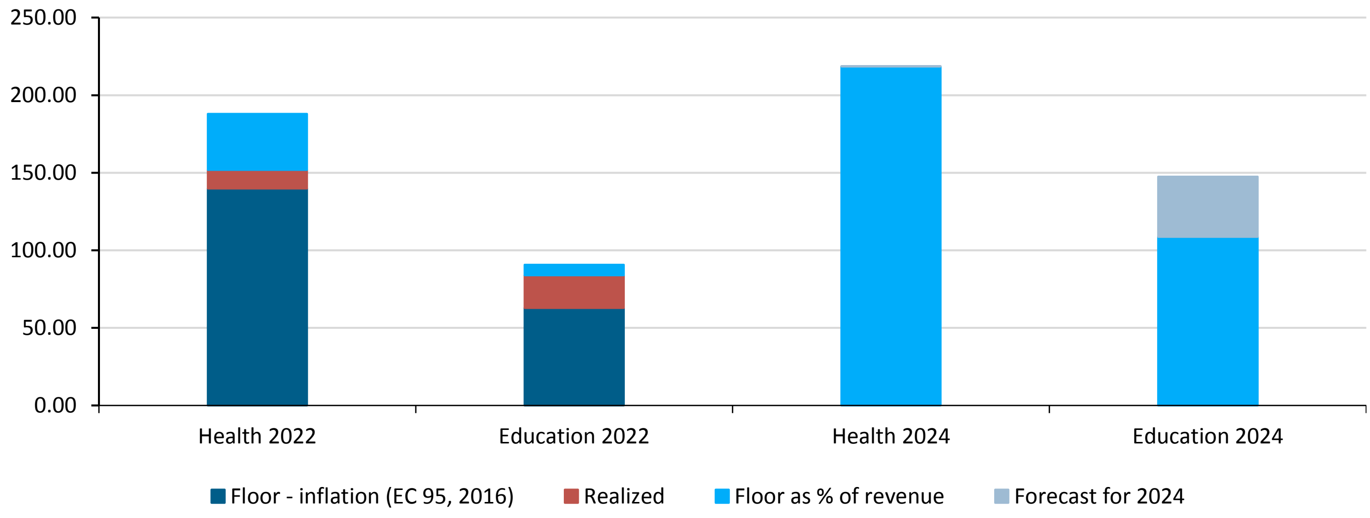
Given this characteristic, which makes the rule more restrictive in the planning phase than in the execution phase, a more detailed evaluation of some expenditure components becomes necessary.

EC 126, from 2022, provided that upon approval of the LC regarding the new fiscal rule to replace the expenditure ceiling created by EC 95, in 2016, certain provisions of the ADCT would be automatically repealed, including those relating to the application of constitutional minimums for Health and Education.

Before the expenditure ceiling established by EC 95, the minimum expenditure on healthcare corresponded to 15% of the Net Current Revenue (RCL) of the Federal Government, and the minimum expenditure on education corresponded to 18% of the federal Net Tax Revenue (RLI). With the expenditure ceiling, these minimum constitutional limits were temporarily changed to be annually adjusted for inflation. With the approval of LC 200, these provisions were repealed, and the constitutional minimum limits for these items of expenditure returned to the previous rules.

Graph 4 displays the minimum spending on health and education for 2022 and 2024, considering the minimums based on the current rule (inflation) and the previous rule (percentage of revenue), as well as the spending/forecasted amount up to this point. It becomes clear that the change in minimum spending on health and education puts some pressure on the 2024 budget.

GRAPH 4. CONSTITUTIONAL FLOORS FOR HEALTH AND EDUCATION IN 2022 AND 2024 (BRL BILLION)



Source: RREO and PLOA 2024. Prepared by: IFI.

Another noteworthy aspect of the PLOA relates to the appropriations planned for spending on RGPS social security benefits. Despite the current policy of real appreciation of the minimum wage and a still high inflation outlook, these

[11]Outstanding liabilities correspond to expenses that were committed in previous years but were not paid in the year of commitment. These outstanding liabilities can be distinguished between processed (committed and settled but not paid) and unprocessed (committed but not settled and not paid). Payments related to outstanding liabilities are called settled outstanding liabilities.

benefits present a scenario of stability in the data as a percentage of GDP (from 8.1% of GDP expected for 2023 to 8.0% in the 2024 PLOA).

The justification for the estimate presented in the PLOA for RGPS benefits is that the government will conduct a registration review of the benefits granted to reduce irregularities. Also mentioned as a justification for the projection adopted are other underlying factors such as measures to automate and optimize the process of returning amounts not intended for the beneficiaries.

In the short term, what is observed is an acceleration in the number of benefits granted, whether in terms of social security benefits or assistance benefits. Concerning assistance benefits, for example, the number of benefit grants jumped from 5,195,802 in December 2022 to 5,407,070 in July 2023 – an increase of 4.1%.

Table 10 presents the main expenditure trends in the PLOA 2024 in comparison to the most recent IFI projection

TABLE 10. PRIMARY EXPENDITURE SCENARIOS: IFI AND PLOA 2024

Breakdown	IFI (2024 Scenario)		PLOA 2024	
	BRL billion	% PIB	BRL billion	% PIB
Primary Expenditure	**2,108.8**	**18.6**	**2,188.4**	**19.2**
Mandatory	**1,961.1**	**17.3**	**2,014.1**	**17.7**
Social Security	932.4	8.2	913.9	8.0
Payroll	378.6	3.3	380.2	3.3
Allowances and unemployment benefits	75.7	0.7	78.6	0.7
BPC	96.8	0.9	103.9	0.9
Bolsa Família [Family Allowance] / Auxílio Brasil [Brazil Aid]	174.0	1.5	168.6	1.5
Court-ordered debt payments (cost and capital)	27.5	0.2	27.5	0.2
Fundeb supplementation	46.9	0.4	46.9	0.4
Subsidies and grants	22.2	0.2	22.2	0.2
Legislative, Judiciary, MPU and DPU	16.3	0.1	21.2	0.2
Payroll exemption	0.0	0.0	0.0	0.0
Extraordinary credits	1.9	0.0	0.0	0.0
Other mandatory	188.8	1.7	251.1	2.2
Executive discretionary	**147.7**	**1.3**	**174.3**	**1.5**

Source: IFI and PLOA 2024. Prepared by: IFI.

Primary balance targets

For 2024, the main fiscal restriction will be the primary balance target. The proposal for a zero deficit outlined in the PLDO for 2024 appears unrealistic when considering only the existing legislation, both in terms of revenues and expenditures.

Given this diagnosis and to enable the submission of the PLOA for 2024 under the guidelines outlined in the PLDO, the government has included in the budget forecast a series of revenues that are still uncertain. This is either because they correspond to projects that are pending in Congress or because they correspond to legal actions with favorable rulings for the Federal Government, but the realization of the considered amounts is still uncertain.

Thus, a second important condition placed in the 2024 budget pertains to expenses funded by these uncertain revenues that have been included in the budget to enable compliance with fiscal rules.

The volume of expenditure conditional on the realization of uncertain revenues amounts to BRL 168.5 billion and has been distributed between primary expenditure and financial expenditure, including the refinancing of the federal public debt. Thus, the non-realization of these revenues or their realization in amounts below expectations increases the fiscal risks associated not only with the provision of primary expenditures but also with the management of the public debt.

In addition to the zero primary balance target for 2024, the RFS establishes that during budget execution, if an incompatibility is evident between the reevaluated results and the achievement of the primary balance targets, the government must proceed with expenditure limitation, also known as a government spending cuts. This expenditure limitation, however, will be limited to 25% of the amount of discretionary expenditure considered in the budget. Thus, although the spending cuts mechanism is still in force, it will be limited compared to the current system.

According to the PLOA, the volume of discretionary spending plus the contingency reserve, which will have to be converted into parliamentary amendments during the processing of this proposal, totaled BRL 211.92 billion. In this sense, it is understood that the maximum amount that can be cut during the 2024 budget execution will be BRL 53 billion. It's worth noting that this amount is lower than the budget allocated for public investments, for which the RFS set a minimum allocation of 0.6% of GDP in the PLOA. The amount subject to cuts is also much lower than the volume of expenses contingent on the realization of uncertain revenues, further increasing the risk of non-compliance with the fiscal target for 2024.

Golden rule

Finally, the PLOA also includes a series of expenses contingent on the approval of a constitutional waiver to comply with the golden rule. Provided for in item III of art. 167 of the Federal Constitution, the golden rule is designed to prevent governments from going into debt to pay for current expenses, such as social security benefits.

According to that constitutional provision, credit operations cannot exceed the amount of capital expenditure, except when the National Congress approves, by an absolute majority, an authorization to disregard the rule. As per the estimates provided in the 2024 PLOA, there is a deficit of BRL 200.2 billion for compliance with the golden rule. Therefore, the approval of this constitutional waiver is necessary, and until this waiver is approved, the values conditionally remain in the budget.

All these conditions increase, to a greater or lesser degree, the risk of non-compliance with the fiscal rules for 2024.

The outlook is for public sector debt to rise as a proportion of GDP in the short term

Alexandre Andrade and Alessandro Casalecchi

Based on the updated projections for the central government's primary income and expenditure, the IFI updated the estimates for the general government's gross debt (DBGG) in 2023 and 2024. By the end of this year, debt as a proportion of GDP should reach 75.8% of GDP, rising to 78.4% of it in 2024. The trajectory of increasing public debt is related to the projected economic slowdown and, above all, to the primary deficits forecasted for the public sector this year and the next. This is expected to lead to an increase in debt that will extend beyond 2024.

This section aims to present the IFI's updated projections for the general government's gross debt (DBGG), an indicator calculated by the Central Bank, in 2023 and 2024, as well as to assess the uncertainties associated with the scenarios in the light of the PLOA 2024. In the previous sections, new estimates were presented for the primary revenue and expenditure of the central government, which includes the National Treasury, the Central Bank, and the INSS. Table 11 summarizes the IFI's projections for these items, as well as the calculation of the primary balance.

TABLE 11. PROJECTIONS FOR THE CENTRAL GOVERNMENT'S PRIMARY BALANCE

Breakdown	2022		2023*		2024*	
	Value (BRL billion)	% of GDP	Value (BRL billion)	% of GDP	Value (BRL billion)	% of GDP
Net revenue	1,856.1	18.7%	1,887.7	17.6%	1,998.9	17.6%
Primary expenditure	1,799.2	18.1%	1,998.3	18.7%	2,108.8	18.6%
Primary balance	**56.9**	**0.6%**	**-110.6**	**-1.0%**	**-109.9**	**-1.0%**

** 2023 and 2024: projections.*

Source: National Treasury Secretariat, IBGE, Central Bank and IFI. Prepared by: IFI.

The table shows the deterioration in the central government's primary balance in 2023, which is expected to record a deficit of BRL 110.6 billion (1.0% of GDP). Next year, the primary deficit is expected to remain at 1.0% of GDP, in the event of (i) the additional measures included in the PLOA 2024 not materializing or (ii) revenues coming in at a lower level than that forecast by the Executive in the budget bill. This trajectory is explained, firstly, by the fall in net primary revenue, which reached 18.7% of GDP in 2022 and is expected to decrease to 17.6% of GDP this year, remaining at this level in 2024.

As highlighted in recent editions of this report, primary revenues have seen a significant increase over the past two years due to a favorable external environment for Brazil, with rising commodity prices and improvements in the terms of trade, which have had direct and indirect effects on tax collections, such as corporate income tax (IRPJ), social contribution on net profits (CSLL), natural resource exploitation, and Petrobras dividends. Commodity prices began to fall in the second half of 2022, at the same time as economic activity began to show signs of weakening.

Secondly, on the expenditure side, the Constitutional Amendment of Transition (EC nº 126, 2022) has led to the restoration and expansion of mandatory and discretionary spending, and the impacts will be felt in the current year and beyond. The fiscal framework has solidified this expansion of expenses, particularly in social assistance benefits, making revenues the central variable for meeting the fiscal targets set in the federal budget guidelines.

Table 12 shows the IFI's new projections for gross debt, as well as the main variables affecting the indicator's dynamics. According to the Central Bank, the DBGG reached 74.0% of GDP in July, already taking into account the adjustment made by the IFI to the GDP series after the release of the quarterly national accounts for the second quarter of 2023. In the year to 2023, the DBGG rose by 1.1 p.p. of GDP and should rise to 75.8% by the end of the year. In 2024, the expectation is for a further increase in debt, which should end the year at 78.4% of GDP.

TABLE 12. PROJECTIONS FOR GENERAL GOVERNMENT GROSS DEBT (2023-2024) - % OF GDP

Breakdown	2022	2023*	2024*
Primary balance of the consolidated public sector	1.3%	-1.0%	-1.1%
Nominal GDP (BRL billion)	9,915	10,700	11,349
GDP - real growth	2.9%	3.0%	1.2%
Implicit GDP deflator	8.3%	4.8%	4.8%
Selic (% p.a.) - end of period	13.75%	11.75%	9.25%
Nominal implicit rate (% p.a.) - end of period	10.8%	10.7%	9.2%
Real implicit rate (% p.a.) - end of period	2.4%	5.7%	4.2%
DBGG (% of GDP)	**72.9%**	**75.8%**	**78.4%**

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

The increase in debt as a proportion of GDP this year and next will occur due to the deterioration in the primary balance of the consolidated public sector, which is expected to go from a surplus of 1.3% of GDP in 2022 to a deficit of 1.0% of GDP in 2023. Another deficit of 1.1% of GDP is projected for 2024. Despite the recent improvement in the primary balance of subnational entities due to the increase in ICMS modal rates and the transfers from the Federal Government in response to the effects of Complementary Laws No. 192 and No. 194 of 2022, IFI's estimate for the primary balance of states and municipalities is zero in 2023 and a deficit of 0.1% of GDP in 2024. In other words, the central government's primary deficit will determine the behavior of the consolidated public sector's primary balance.

The behavior of other variables will also affect debt dynamics this year and next, such as the implicit GDP deflator. In 2021 and 2022, the implicit deflator rose by 11.4% and 8.3% respectively. By 2023, the indicator is expected to fall to 4.8%. The deflator affects the trajectory of the debt-GDP ratio in two ways: firstly, through the growth of nominal GDP, since the greater relative increase in the denominator causes the ratio to fall; and secondly, through the implicit real debt rate. The IFI uses the implicit GDP deflator to adjust the nominal implicit gross debt rate instead of the IPCA. As the projected deflator will be lower in 2023 and 2024, the real implicit rate will be higher, even with the expected reduction in the nominal implicit rate.

Another piece of evidence regarding the increasing trajectory of the debt-to-GDP ratio can be found in the data related to the determining factors of gross debt, published monthly by the Central Bank, which indicates a decrease in the contribution of nominal GDP to the debt-to-GDP ratio since 2022. In the last two years, the increases in nominal GDP have more than offset the evolution of the other factors affecting gross debt, especially nominal interest payments, in reducing the debt/GDP ratio. As economic activity began to slow down and inflation eased, this contribution from GDP started to decrease, a trend that is expected to continue in 2024. At the same time, interest expenditure is expected to fall as the Central Bank begins to loosen its monetary policy. In any case, this movement will not be enough to compensate for the slowdown in GDP. As a result, the debt/GDP ratio will rise this year and next.

Moving on to the analysis of the sustainability of the gross debt over time, Table 13 updates a recurring exercise carried out by the IFI to calculate the primary balance of the public sector needed to stabilize the debt as a proportion of GDP, based on values for the real growth of the economy and the implicit real interest rate of the debt. The exercise considered gross debt at 75.8% of GDP, which is the IFI's projection for the variable at the end of 2023.

TABLE 13. PRIMARY BALANCE REQUIRED TO STABILIZE GROSS DEBT AT 75.8% OF GDP

DBGG in t		Implicit real interest from DBGG							
75,8%		0.5%	1.0%	2.0%	3.5%	3.8%	4.5%	5.0%	5.5%
Real GDP (% p.a.)	0.5%	0.0%	0.4%	1.1%	2.3%	2.5%	3.0%	3.4%	3.8%
	1.0%	-0.4%	0.0%	0.8%	1.9%	2.1%	2.6%	3.0%	3.4%
	1.5%	-0.7%	-0.4%	0.4%	1.5%	1.7%	2.2%	2.6%	3.0%
	2.0%	-1.1%	-0.7%	0.0%	1.1%	1.3%	1.9%	2.2%	2.6%
	2.5%	-1.5%	-1.1%	-0.4%	0.7%	1.0%	1.5%	1.8%	2.2%
	3.0%	-1.8%	-1.5%	-0.7%	0.4%	0.6%	1.1%	1.5%	1.8%
	3.5%	-2.2%	-1.8%	-1.1%	0.0%	0.2%	0.7%	1.1%	1.5%

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

Considering a convergence of implicit real interest rates on gross debt to 3.8% per year by the end of this decade and real economic growth of 2.0% (Brazil's potential GDP according to IFI's calculation methodology), the primary surplus required to stabilize the debt would be 1.3% of GDP. Table 13 shows that the higher the interest rate, the greater the primary balance required to stabilize the debt. On the other hand, higher economic growth reduces the required primary balance. In a situation of real interest rates of 2.0% p.a. and potential economic growth of 2.5%, even a public sector primary deficit of 0.4% of GDP would be enough to stabilize gross indebtedness at the level projected by the IFI for the end of 2023 (75.8% of GDP).

It should be noted that the exercise presented in Table 13 keeps the other variables that affect debt dynamics constant. External shocks, for example, can affect the sustainability of the gross debt. As mentioned earlier, in 2021 and 2022 there was a favorable external shock for the Brazilian economy, which pushed up commodity prices and improved the country's terms of trade. In these situations, commodity-exporting economies benefit from these higher prices, which have a boosting effect on economic activity; government revenues tend to grow above GDP, which improves governments' primary balance, even if there are incentives to contract new expenditures.

In the previous scenario review published by IFI, in June, which incorporated the elements of the fiscal framework bill then under consideration, gross debt was growing over time until the beginning of the next decade due to successive primary deficits accumulated by the public sector. In a situation where society chooses to restore mandatory and discretionary expenses, one of the conclusions presented was the reliance on revenues to achieve primary surpluses by the public sector, particularly the central government. Although the IFI has not updated its projections for the medium term (2025 to 2032), this conclusion is maintained in this analysis.

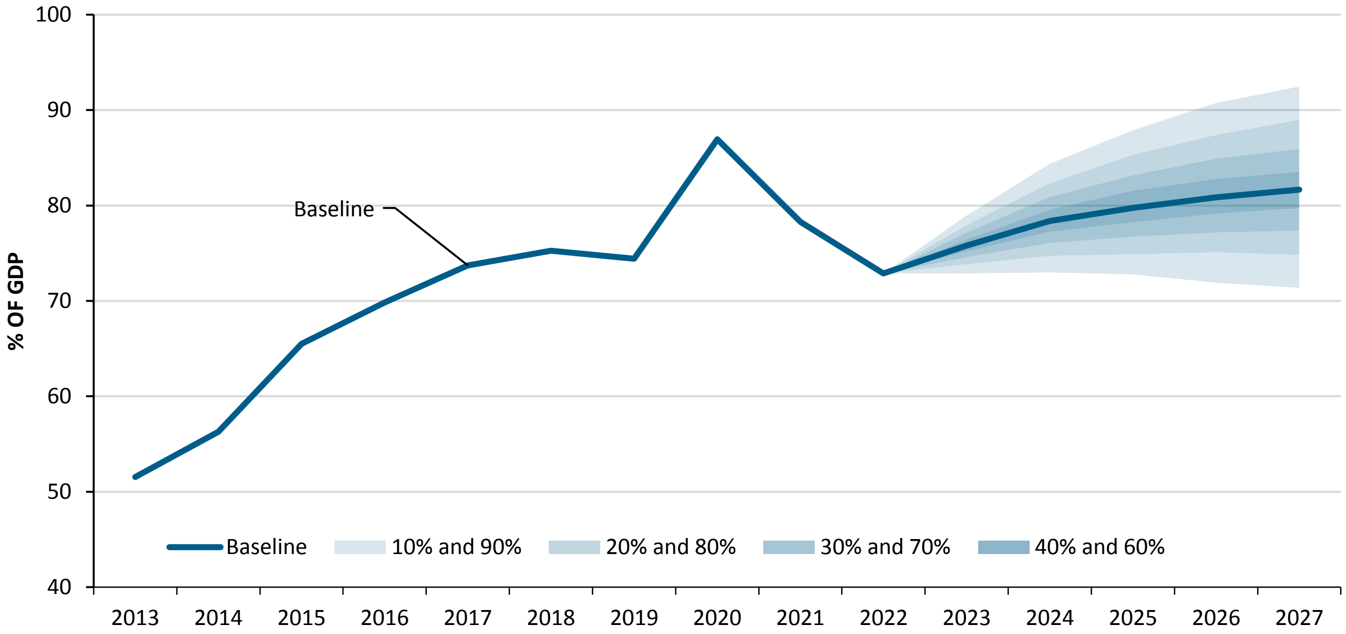
As discussed in the section presenting the revenue projections of the central government and the measures included in the 2024 budget bill, the challenges to achieving the necessary revenue increases to meet the fiscal targets set in the 2024 PLDO (zero deficit in 2024, a surplus of 0.5% of GDP in 2025, and a surplus of 1.0% of GDP in 2026) are significant, especially in the absence of positive external shocks, as seen in the recent period. According to projections by the IFI and other institutions, the country's potential GDP growth, i.e. the economy's capacity to grow without generating macroeconomic imbalances, is 2.0% per year.

A rise in potential GDP would require productivity increases in the economy, especially in a context where the country is approaching the end of the demographic bonus. Reforms in consumption taxation, like the one currently under discussion in Congress, have the potential to enhance the productivity of the economy and generate long-term growth benefits.

To conclude this section, the IFI presents an update to the stochastic debt scenarios. The probability of DBGG exceeding 90% of GDP by 2027 was estimated at 18.2%. This RAF updated the DBGG fan chart, which was published in RAF 77 of June 2023. The fan chart complements the baseline deterministic scenario and is generated from 1,500 stochastic scenarios for DBGG. Stochastic scenarios also make it possible to estimate probabilities regarding the trajectory of public debt over the next few years. Given the assumptions in our baseline scenario, the probability of the DBGG crossing the threshold of 90% of GDP in any year between 2023 and 2027 was estimated at 18.2%. This is a significant reduction compared to the probability reported in the June RAF (42.3%). The main reason for this decline is the downward shift in the baseline scenario, as evidenced, for example, by the fact that in the June RAF, the DBGG crossed 80% of GDP in 2024. Now, the crossover takes place further ahead, in 2026.

Although the probability of crossing 90% of GDP has decreased, Graph 5 suggests that - as already indicated in previous reports - the DBGG is unlikely to continue on a downward path in the coming years. The probability that the gross debt in 2027 will be higher than the level at the end of 2022 (72.9% of GDP) was estimated at 86.3% (in June, the estimate was 96.9%).

GRAPH 5. BASELINE SCENARIO AND STOCHASTIC SCENARIOS (FAN CHART) FOR DBGG



Source: IFI. Explanatory note: the values on the left axis indicate the percentage that general government gross debt represents of GDP. The percentages indicated in the legend at the bottom of the graph show which percentile of the 1,500 simulated trajectories each blue band represents. For example, 60% of the simulated values are in the range labeled "40% and 60%" or in the ranges below it. In other words, in each year, 40% of the trajectories are above the top line of the range labeled "40% and 60%".

IFI Projections

SHORT TERM

IFI Projections	2023			2024		
	August	September	Comparison	August	September	Comparison
GDP - real growth (% p.a.)	2.28	2.97	▲	1.22	1.22	▲
GDP - nominal (BRL billion)	10,647.66	10,699.91	▲	11,294.10	11,348.79	▲
IPCA - accumulated (% in the year)	5.20	5.11	▼	3.88	3.84	▼
Exchange rate - end of period (BRL/US$)	5.02	5.08	▲	5.09	5.15	▲
Employment - growth (%)	0.75	1.10	▲	0.68	0.98	▲
Payroll - growth (%)	4.28	5.14	▲	1.22	1.28	▲
Selic - end of period (% p.a.)	12.00	11.75	▼	9.50	9.50	=
Real interest ex-ante (% p.a.)	6.37	6.26	▼	5.77	5.33	▼
Consolidated Public Sector Primary balance (% of GDP)	-1.20	-1.03	▲	-1.33	-1.07	▲
of which Central Government	-0.80	-1.03	▼	-0.93	-0.97	▼
Net Nominal Interest (% of GDP)	7.01	6.70	▼	6.09	5.34	▼
Nominal Result (% of GDP)	-8.20	-7.73	▲	-7.43	-6.41	▲
General Government Gross Debt (% of GDP)	76.40	75.79	▼	79.78	78.39	▼

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