



BRAZIL

July 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BRAZIL

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Brazil, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 8, 2024 consideration of the staff report that concluded the Article IV consultation with Brazil.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 8, 2024, following discussions that ended on May 27, 2024, with the officials of Brazil on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 20, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Brazil.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.



IMF Executive Board Concludes 2024 Article IV Consultation with Brazil

FOR IMMEDIATE RELEASE

Washington, DC – July 11, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Brazil.

Over the past two years, Brazil's economy has shown remarkable resilience as inflation has declined to within the target tolerance interval. Real GDP growth in 2023, at 2.9 percent, was significantly higher than projected at the start of the year, on the back of record agricultural and hydrocarbon output, and resilient services. Consumption was strong, amid a tight labor market and a sizeable fiscal stimulus. Economic activity in early 2024 remained robust.

Growth is projected to moderate to 2.1 percent in 2024, reflecting still restrictive monetary policy, a lower fiscal deficit, the flood calamity in *Rio Grande do Sul*, and the normalization of agricultural output. Growth is projected to strengthen to 2.5 percent over the medium term, an upward revision of 0.5 percentage point since the 2023 Article IV Consultation, supported by efficiency gains from the VAT reform and growing hydrocarbon output. Investment in green growth opportunities could further lift economic potential. Headline inflation is expected to return to the 3 percent target in the first half of 2026.

The balance of risks to the growth outlook has improved since the 2023 Article IV Consultation but remains somewhat tilted to the downside, while uncertainty remains. Downside risks stem, on the external front, from possible monetary policy miscalibration in major economies, commodity price volatility, and global financial instability. On the domestic front, supply disruptions from the 2024 flood calamity could be more severe than expected. Uncertainty over fiscal measures could reduce policy credibility, resulting in higher borrowing costs and increased risks of inflation expectations de-anchoring. Upside risks stem from stronger-than-expected household consumption, faster-than-expected implementation of productivity-enhancing reforms, and investment in green growth opportunities. A sound financial system, adequate FX reserves, low reliance on FX debt, large government cash buffers, and a flexible exchange rate continue to support Brazil's resilience.

Executive Board Assessment²

Executive Directors welcomed the Brazilian economy's remarkable resilience during the disinflation process, as well as the expected convergence to stronger potential growth over the medium term. They also commended the authorities' progress in advancing their ambitious agenda for sustainable and inclusive growth. Looking ahead, they encouraged the authorities

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

to ensure the continued convergence of inflation to target, secure fiscal sustainability, and continue to pursue structural reforms to tackle long-standing challenges.

Directors commended the authorities' commitment to continue improving the fiscal position supported by expenditure and revenue measures. They welcomed the VAT reform, which is expected to boost productivity, create formal employment, and improve taxation equity. Many Directors recommended a sustained and more ambitious fiscal effort that puts public debt on a firmly downward path and opens space for priority investments. Broadening the tax base, rationalizing inefficient tax expenditures, tackling budget rigidities, and enhancing the efficiency of social transfer programs would support this effort. An enhanced fiscal framework with a strong medium-term fiscal anchor would reinforce credibility and sustainability.

Directors welcomed the authorities' decisive efforts to bring down inflation. They commended the careful pace of monetary policy easing, which is consistent with the inflation targeting framework, and stressed that maintaining flexibility on the pace and length of the easing cycle will remain important. They noted that the Central Bank of Brazil's (BCB) policies and commitment to the 3-percent inflation target bode well for the further decline in inflation expectations. The continued credibility of both fiscal and monetary policy frameworks will be important in this regard. Directors noted that the flexible exchange rate regime and adequate FX reserves remain valuable shock buffers. They positively noted the ongoing implementation of the plan to gradually reduce the financial transaction tax on certain foreign exchange transactions to zero, which would eliminate a multiple currency practice.

Directors concurred that the financial system remains resilient, systemic risks are contained, and banks are highly liquid and adequately capitalized. They welcomed steps to strengthen the oversight of non-bank financial institutions, address households' debt burden, and lower credit costs. Directors emphasized that careful management of a bigger role for public banks is warranted to mitigate potential risks to the fiscal position, monetary policy transmission, and market efficiency. They welcomed the authorities' financial innovation agenda, which has promoted financial inclusion, efficiency, and competition. They concurred that providing the BCB with flexibility to cover operating expenses would support continued progress with technological innovations.

Directors welcomed the progress in implementing Brazil's Ecological Transformation Plan. They commended the authorities on their commitment to halt illegal deforestation and welcomed the new carbon market framework and progress in designing instruments to attract longer-term green financing, and more generally welcomed Brazil's pioneering role in this area. These initiatives are expected to facilitate the transition to a low-carbon economy, encourage investment in sustainable projects, and boost economic output. Directors also emphasized that continued efforts to advance trade integration, strengthen the anti-corruption and AML/CFT frameworks, and facilitate skills upgrading would yield significant gains in potential growth. Directors welcomed Brazil's leadership role during their G20 Presidency.

Table 1. Brazil: Selected Economic Indicators 2022-29

| | | I. Social and Demographic Indicators | | | | | | |
|---|-------|---|--|-------|-------|-------|-------------------|-------|
| Area (thousands of sq. km.) | 8,510 | Health | | | | | | |
| Agricultural land (percent of land area) | 30.2 | Physicians per 1000 people (2023) | | | | | 2.6 | |
| | | Hospital beds per 1000 people (2023) 1/ | | | | | 2.4 | |
| Population (2023) | | Access to safe water (2022) | | | | | 88.0 | |
| Total (millions) | 216.3 | | | | | | | |
| Annual rate of growth (percent) | 0.7 | Education (2023) | | | | | | |
| Density (per sq. km.) | 25.4 | Adult illiteracy rate | | | | | 5.4 | |
| Unemployment rate (Q1, 2024) | 7.9 | Net enrollment rates, percent in: | | | | | | |
| | | Primary education | | | | | 99.4 | |
| Population characteristics (2022) | | Secondary education | | | | | 92.2 | |
| Life expectancy at birth (years) | 75.5 | | | | | | | |
| Infant mortality (per thousand live births) | 12.6 | Poverty rate (in percent, 2022) 2/ | | | | | 31.6 | |
| | | | | | | | | |
| Income distribution (2022) | | GDP, local currency (2023) | | | | | R\$10,856 billion | |
| Palma ratio 3/ | 3.6 | GDP, dollars (2023) | | | | | US\$2,174 billion | |
| Gini coefficient (post taxes and transfers) | 51.8 | GDP per capita (2023) | | | | | US\$10,050 | |
| Main export products: airplanes, metallurgical products, soybeans, automobiles, electronic products, iron ore, coffee, and oil. | | | | | | | | |
| II. Economic Indicators | | | | | | | | |
| | 2022 | 2023 | Proj. | | | | | |
| | | | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| National accounts and prices | | | (Annual percentage change) | | | | | |
| GDP at current prices | 11.8 | 7.7 | 7.2 | 6.0 | 5.9 | 6.0 | 6.1 | 6.1 |
| GDP at constant prices | 3.0 | 2.9 | 2.1 | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 |
| Consumption | 3.7 | 2.8 | 2.0 | 2.2 | 2.1 | 2.1 | 2.3 | 2.3 |
| Investment (GFCF) | 1.1 | -3.0 | 0.8 | 0.9 | 1.3 | 1.4 | 1.6 | 1.7 |
| Consumer prices (IPCA, average) | 9.3 | 4.6 | 4.0 | 3.2 | 3.1 | 3.0 | 3.0 | 3.0 |
| Consumer prices (IPCA, end of period) | 5.8 | 4.6 | 3.7 | 3.2 | 3.0 | 3.0 | 3.0 | 3.0 |
| GDP deflator | 8.5 | 4.7 | 5.0 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 |
| Gross domestic investment | | | (Percent of GDP) | | | | | |
| Private sector | 14.3 | 12.4 | 12.2 | 11.9 | 11.7 | 11.6 | 11.5 | 11.4 |
| Public sector | 3.7 | 3.7 | 3.7 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| Gross national saving | | | | | | | | |
| Private sector | 19.2 | 21.9 | 20.5 | 20.3 | 19.3 | 18.8 | 18.3 | 17.8 |
| Public sector | -3.6 | -7.2 | -6.4 | -6.3 | -5.5 | -5.1 | -4.6 | -4.2 |
| Public sector finances | | | | | | | | |
| Central government primary balance (national representation, incl. BCB) 4/ | 0.5 | -2.4 | -0.6 | -0.7 | -0.4 | 0.1 | 0.6 | 1.0 |
| General government NLB primary balance | 1.3 | -2.0 | -0.7 | -0.8 | -0.4 | 0.1 | 0.6 | 1.0 |
| General government NLB structural primary balance (in percent of potential GDP) | -0.7 | -2.2 | -1.5 | -1.0 | -0.5 | 0.1 | 0.6 | 1.0 |
| General government NLB | -4.0 | -7.6 | -6.8 | -6.8 | -5.9 | -5.5 | -5.1 | -4.7 |
| Net public sector debt | 56.1 | 60.9 | 61.4 | 65.9 | 68.3 | 70.0 | 71.1 | 71.8 |
| General government gross debt, Authorities' definition | 71.7 | 74.4 | 77.1 | 80.5 | 82.1 | 83.4 | 84.0 | 84.3 |
| General government gross debt | 83.9 | 84.7 | 87.5 | 91.2 | 93.1 | 94.5 | 95.1 | 95.4 |
| Of which: Foreign currency linked | 4.0 | 3.6 | 3.6 | 3.7 | 3.7 | 3.8 | 3.8 | 3.8 |
| Money and credit | | | (Annual percentage change) | | | | | |
| Base money 5/ | 16.6 | 20.4 | 7.2 | 6.0 | 5.9 | 6.0 | 6.1 | 6.1 |
| Broad money 6/ | 10.6 | 15.5 | 7.3 | 5.9 | 6.0 | 6.0 | 6.1 | 6.1 |
| Bank loans to the private sector | 14.6 | 6.9 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 |
| Balance of payments | | | (Billions of U.S. dollars, unless otherwise specified) | | | | | |
| Trade balance | 44.2 | 80.6 | 78.2 | 80.4 | 83.4 | 90.0 | 95.4 | 100.9 |
| Exports | 340.3 | 344.4 | 345.6 | 350.4 | 357.1 | 369.3 | 380.1 | 391.7 |
| Imports | 296.2 | 263.8 | 267.4 | 270.0 | 273.8 | 279.3 | 284.7 | 290.8 |
| Current account | -48.3 | -30.8 | -40.0 | -40.8 | -42.9 | -44.7 | -45.5 | -47.4 |
| Capital account and financial account | 47.0 | 29.7 | 40.0 | 40.8 | 42.9 | 44.7 | 45.5 | 47.4 |
| Foreign direct investment (net inflows) | 41.3 | 36.0 | 37.2 | 38.7 | 40.3 | 41.8 | 43.4 | 45.1 |
| Terms of trade (percentage change) | -7.1 | 2.4 | -3.4 | -2.0 | -2.0 | -1.0 | -0.7 | -0.8 |
| Merchandise exports (in US\$, annual percentage change) | 19.8 | 1.2 | 0.3 | 1.4 | 1.9 | 3.4 | 2.9 | 3.0 |
| Merchandise imports (in US\$, annual percentage change) | 19.6 | -10.9 | 1.4 | 0.9 | 1.4 | 2.0 | 1.9 | 2.1 |
| Total external debt (in percent of GDP) | 34.9 | 33.7 | 32.6 | 32.3 | 31.0 | 29.7 | 28.6 | 27.5 |
| Memorandum items: | | | (Percent, unless otherwise specified) | | | | | |
| Output Gap | 0.1 | 0.6 | 0.4 | 0.3 | 0.2 | 0.1 | 0.0 | 0.0 |
| Current account (in percent of GDP) | -2.5 | -1.4 | -1.8 | -1.7 | -1.7 | -1.7 | -1.6 | -1.6 |
| Unemployment rate 7/ | 9.3 | 8.0 | 7.6 | 7.4 | 7.4 | 7.4 | 7.5 | 7.5 |
| Gross official reserves (in US\$ billions) | 325 | 355 | 355 | 355 | 355 | 355 | 355 | 355 |
| REER (annual average in percent; appreciation +) | 12.1 | 4.6 | ... | ... | ... | ... | ... | ... |

Sources: Central Bank of Brazil, Ministry of Finance, IBGE, IPEA, and Fund staff estimates.

1/ Includes inpatient beds and complementary beds.

2/ Computed by IBGE using World Bank's threshold for upper-middle income countries (US\$5.5/day).

3/ Share of income of the top 10% divided by share of income of the bottom 40%.

4/ Includes federal government, Central Bank, and the social security system (INSS). The 2023 primary balance excludes pandemic-related funds from PIS/PASEP, as per BCB definition.

5/ Currency issued, required deposits held at the Central Bank plus other Central Bank liabilities to other depository corporations.

6/ Currency outside depository corporations, transferable deposits, other deposits and securities other than shares.

7/ Unemployment rate for 2022 and 2023 shows the average of March, June, September, and December.



BRAZIL

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

June 20, 2024

KEY ISSUES

Context. Brazil's economy has shown remarkable resilience amid the ongoing disinflation. Economic activity has grown steadily, surpassing expectations, reflecting favorable demand and supply factors. With proactive and adequately restrictive monetary policy, headline inflation has declined to the target tolerance interval. Long-standing challenges remain, including elevated public debt and slow convergence to higher living standards. The authorities have advanced their ambitious sustainable and inclusive growth agenda, including the approval of a landmark VAT reform.

Outlook. GDP growth is expected to moderate in 2024, reflecting still restrictive monetary policy, a lower fiscal deficit, the flood calamity in *Rio Grande do Sul*, and normalization of agricultural output. Growth is projected to strengthen to 2.5 percent over the medium term, an upward revision of 0.5 percentage point since the 2023 Article IV Consultation, supported by efficiency gains from the VAT reform and growing hydrocarbon output. Investment in green growth opportunities could further boost economic potential. Headline inflation is expected to return to the 3 percent target in the first half of 2026. The federal primary fiscal balance is projected to rise gradually over the medium term, contingent on the implementation of measures, with general government gross debt stabilizing at about 95 percent of GDP.

Risks. Risks to the outlook are somewhat tilted to the downside, while uncertainty remains. Downside risks stem, on the external front, from possible monetary policy miscalibration in major economies, commodity price volatility, and global financial instability. On the domestic front, supply disruptions from the 2024 flood calamity could be more severe than expected. Uncertainty over fiscal measures could reduce policy credibility, resulting in higher borrowing costs and increased risks of inflation expectations de-anchoring. Upside risks stem from stronger-than-expected household consumption, faster-than-expected implementation of productivity-enhancing reforms, and green growth opportunities. Strong buffers continue to support resilience.

Policy Recommendations

Monetary and Exchange Rate Policy. The careful pace of monetary easing since August 2023 has been appropriate and consistent with the inflation targeting framework. Forward guidance in past central bank communications was effective in

guiding market expectations. As disinflation proceeds, with inflation projected to remain within the target tolerance interval, maintaining flexibility on the pace and length of the easing cycle is prudent given a tight labor market and above-target inflation expectations. The flexible exchange rate regime and adequate foreign exchange (FX) reserves continue to provide Brazil with valuable shock buffers.

Financial Sector Policies. The financial sector remains resilient with systemic risks contained. The authorities' initiatives and a buoyant economy have strengthened household balance sheets. Continued careful management of a bigger role for public banks will help to mitigate any potential risks to the fiscal position, monetary policy transmission, and market efficiency. Ensuring adequate resources for the Central Bank of Brazil (BCB), notably staffing, will allow the authorities to continue advancing the financial innovation agenda.

Fiscal Policy. The authorities' commitment to continue improving the fiscal position is welcome. To put public debt on a firmly downward path and open space for priority investments, staff recommends a sustained and more ambitious fiscal effort. Additional revenues from tax base broadening, including by rationalizing inefficient tax expenditures, could support part of the adjustment. Expenditure reforms to tackle budget rigidities remain essential. Building on the fiscal rule, an enhanced fiscal framework would help reduce uncertainty and support credibility and sustainability. The landmark VAT reform is expected to boost productivity and improve equity of the tax system and efforts are rightly geared towards effective implementation.

Structural Reforms. The authorities have advanced their ambitious agenda to foster sustainable, inclusive, and green economic growth. Continuing implementation of reforms that promote trade integration, enhance governance, and simplify business regulation would yield productivity gains. Intensifying ongoing efforts to boost labor force participation, including for women, and facilitate skill upgrading would mitigate the expected drag from population aging on potential growth. Ensuring that trade and investment measures remain targeted to addressing market failures and avoid discriminatory measures is important. Increasing the effectiveness of social programs and the progressivity of the tax system would help reduce inequality and poverty, while supporting fiscal sustainability and resilience. Recent initiatives on climate financing are welcome and could generate important resources for the Ecological Transformation Plan.

Approved By
Rodrigo Valdes
 (WHD) and **Martin**
Čihák (SPR)

Discussions took place in Brasília, São Paulo, and Rio de Janeiro during May 15-27, 2024. The mission met with Finance Minister Haddad, Central Bank Governor Campos Neto, other senior public officials, and private sector representatives. The team included Ana Corbacho and Daniel Leigh (heads), Jean Francois Clevy, Swarnali Hannan, Christina Kolerus, and Bunyada Laoprapassorn (all WHD), Miguel Pecho (FAD), Yiqun Wu (SPR), and Rui Xu (MCM). Afonso Bevilaqua, Pedro Miranda, and Bruno Saraiva (OED) participated in many of the discussions. Dimitris Drakopoulos (WHD) contributed inputs on monetary policy, financial sector, and debt; Alejandro Badel (SPR) and Ana Cebreiro Gomez (FAD) on VAT reform; and Marina Tavares (RES) on Artificial Intelligence. Carlos Guevara, Kristine Laluces, and Gabriel Moura provided editorial and research assistance.

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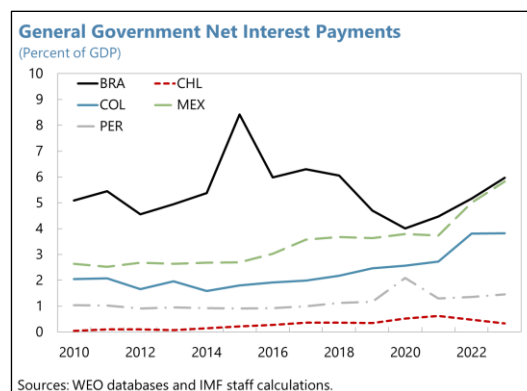
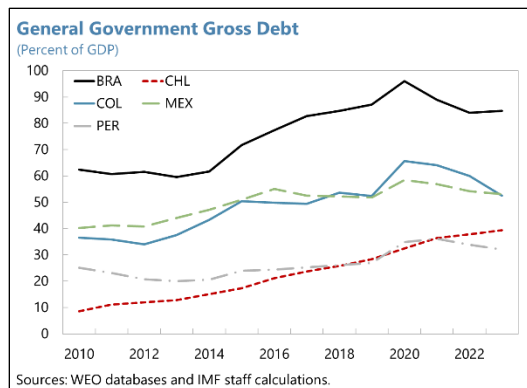
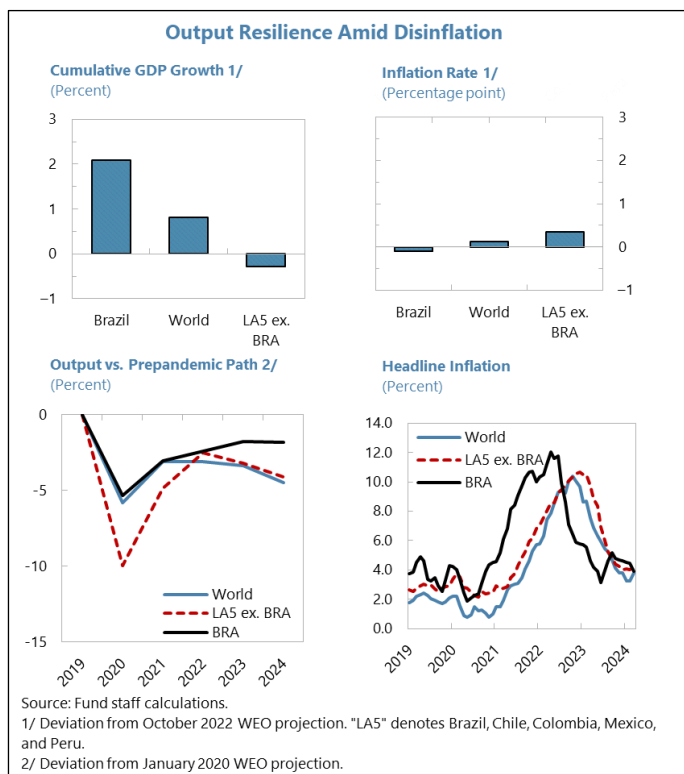
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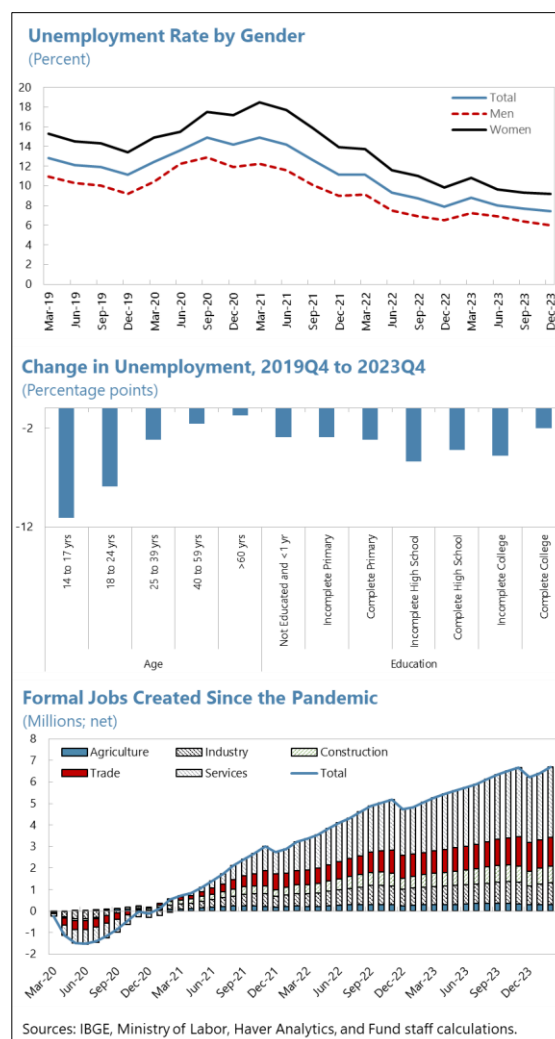
ECONOMIC RESILIENCE AMID DISINFLATION

1. Brazil's economy has been remarkably resilient during the disinflation process of the last two years. During 2022 and 2023, real GDP rose by a cumulative 5.9 percent—surpassing the projection in the October 2022 *World Economic Outlook* (WEO) by over 2 percentage points. The stronger growth, despite tight monetary policy to reduce inflation, reflected supportive demand conditions—including higher government spending and robust private consumption. It also reflected a supply-side expansion, including record agricultural and hydrocarbon output (Annex I). Economic activity in Brazil has recovered faster toward its pre-pandemic path than in regional peers or the world economy. Inflation was lower than expected and returned to the target tolerance interval in March 2023. Growth is expected to moderate this year amid still restrictive interest rates aimed at completing the convergence of inflation to target; a lower fiscal deficit; the flood calamity in *Rio Grande do Sul*, and slower agricultural output.

2. At the same time, some long-standing challenges persist. The general government gross debt-to-GDP ratio, which declined in 2021–22 to below its pre-pandemic level, increased in 2023 on the back of a fiscal expansion and is set to rise further in the near term before stabilizing over the longer policy horizon. Net interest payments reached nearly 6 percent of GDP in 2023, above regional peers, constraining space for priority investments. Estimates of potential growth, though rising in recent years, remain below the average of the Group of Twenty (G20) emerging market economies, slowing efforts to converge toward higher living standards.



3. The authorities have advanced their ambitious sustainable and inclusive growth agenda, while ensuring sound macroeconomic management.¹ The transformation toward a green economy is accelerating, with deforestation in the Amazon cut by half in 2023 alongside a government commitment to halt illegal deforestation by 2030; important progress on establishing Brazil's Sustainable Taxonomy; a new carbon market framework; and the issuance of the first Global ESG sustainable government bond. The expansion of social protection policies, including the *Bolsa Família* conditional cash transfer program targeted to the poor, and the new targeted *Desenrola* program to restructure lower-income household debt are supporting poverty alleviation and financial inclusion. Recent initiatives in the financial sector, including the highly successful instant payment system *Pix*, have placed Brazil at the forefront of financial innovation and increased financial inclusion, efficiency, and competition. On the fiscal front, milestones included approving a landmark VAT reform in 2023. Finally, on the inflation targeting framework, the decision in June 2023 by the National Monetary Council to adopt a continuous 3 percent inflation target from 2025 onwards has reduced uncertainty and enhanced monetary policy effectiveness. These steps strengthen Brazil's path toward rising economic wellbeing alongside environmental and macroeconomic sustainability.

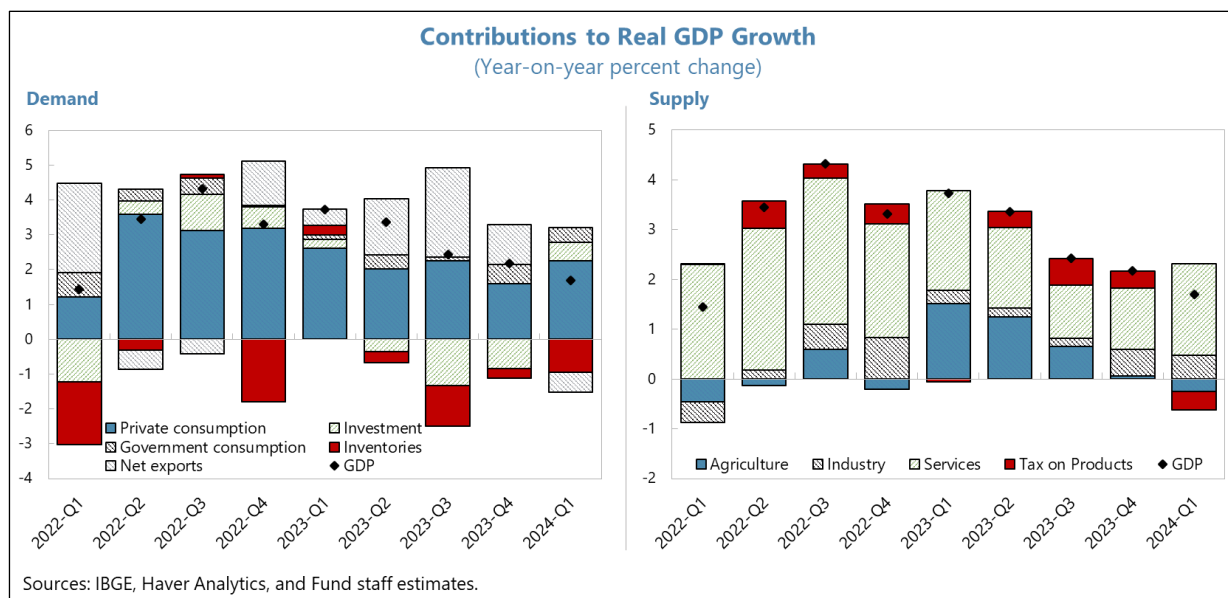


RECENT DEVELOPMENTS

4. Economic activity remained strong in 2023 and early 2024. Real GDP growth, at 2.9 percent in 2023, was significantly higher than projected at the start of the year, on the back of record agricultural and hydrocarbon output, and resilient services. Private consumption grew by 3.1 percent on account of a tight labor market, real income gains, and a sizable fiscal stimulus. Growth in the first quarter of 2024 remained robust at 2.5 percent on a year-over-year basis, driven by robust private consumption in the context of a strong labor market. In addition, after declining by 3.0 percent in 2023, investment grew by 2.7 percent on a year-over-year basis. The unemployment rate reached 7.5 percent in the moving quarter through April—the lowest rate over the same period since 2014, with joblessness falling across all major demographic groups, especially the young and

¹ See [Mensagem ao Congresso Nacional](#), January 2024.

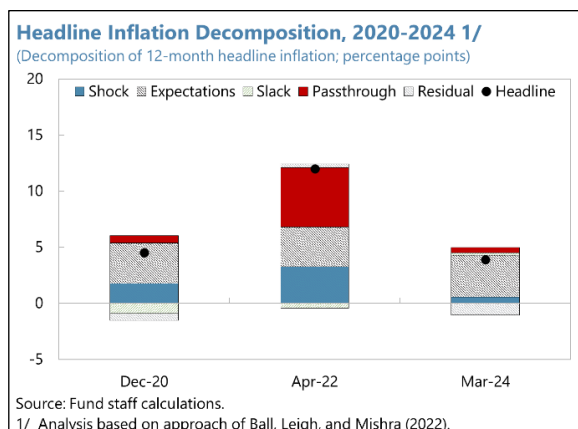
those with incomplete high school education. Formal employment surpassed its pre-pandemic level in January 2021.



5. The trade balance rose significantly in 2023, driven by strong exports in agriculture and crude oil. The current account deficit narrowed from 2.5 percent of GDP in 2022 to 1.4 percent of GDP in 2023 on the back of the larger trade surplus. The current account deficit was entirely financed by robust net Foreign Direct Investment (FDI) inflows (1.7 percent of GDP) and portfolio inflows (0.3 percent of GDP). Staff analysis (Annex II) suggests that progress in trade liberalization (including lowering import tax rates and reducing non-tariff barriers), financial market development, and regulatory reform over the past decade were key structural drivers that attracted FDI. The Brazilian *real* appreciated against the US dollar by an average of 3.4 percent in 2023 from the 2022 average, on the back of the improved economic outlook, while the real effective exchange rate (REER) appreciated by 4.6 percent. As of May, the Brazilian *real* had depreciated by about 4.5 percent against the US dollar since December 2023, amid a global market re-assessment of the timing of US monetary policy easing and heightened geopolitical uncertainty. Staff assessed the external position in 2023 as broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex III). In the first few months of 2024, the trade surplus remained high, on the back of strong exports in commodities and only marginally higher imports compared with 2023.

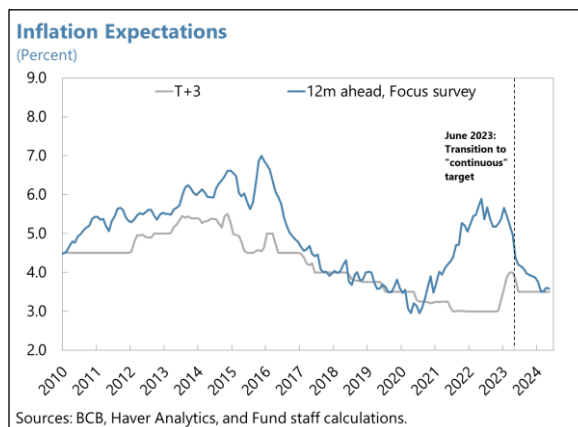
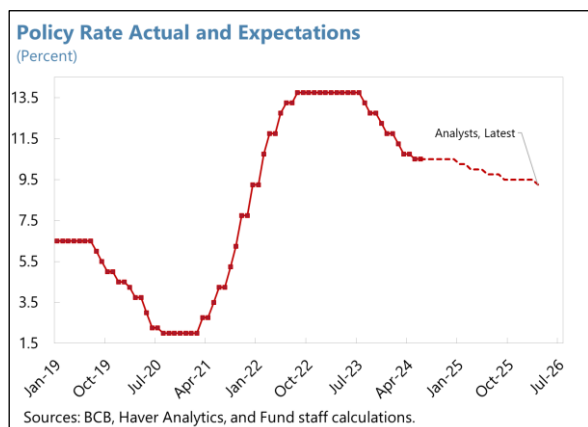
6. Price pressures have eased significantly.

In May, headline inflation was 3.9 percent year-over-year, within the target tolerance interval (3.0 percent \pm 1.5 percentage points). Underlying (core) inflation measures were at similar levels. The

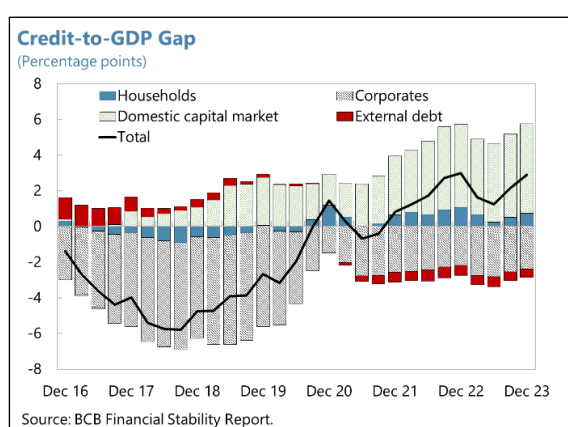


level of real wages has recovered to near its pre-pandemic path. Staff analysis suggests that the fall in headline inflation since its peak of 12.1 percent (year-over-year) in April 2022 largely reflects the unwinding of earlier relative price increases—notably for energy—and the fading of the related pass-through into underlying inflation (Annex IV). An important pass-through channel has been the fall in near-term inflation expectations (Figure 2), supported by BCB’s decisive monetary policy action and clear communication. So far, the positive output gap has contributed only modestly to inflation.

7. With inflation on a clearly declining path, the BCB started lowering rates in August 2023 and introduced forward guidance. After 50 basis point rate cuts for six meetings, the BCB reduced rates by 25 basis points to 10.50 percent in May and kept rates unchanged in June. The BCB adjusted its initial guidance of cuts of 50 basis points per meeting in March and removed explicit signaling of a rate cut in May to gain more flexibility on the pace and the length of the easing cycle. The adoption of a continuous target of 3 percent from 2025 onwards allayed market concerns around the evolution of the inflation target and strengthened monetary policy effectiveness. However, medium-term inflation expectations have remained at about 50 basis points above target, possibly reflecting uncertainties over the fiscal consolidation path as well as the composition of the BCB Board of Governors after the terms of three out of nine members expire in December 2024 (in line with the Central Bank Autonomy Law of 2021).



8. Credit growth has decelerated reflecting the still restrictive monetary policy stance, while the overall credit gap remains positive. Bank credit growth declined to 9 percent year-over-year in April, down from 18 percent in mid-2022. The BCB’s estimated credit gap remains positive and driven mainly by continued deepening of domestic capital markets. New bank loan origination has started to rise in the context of the easing cycle. New loans to households are concentrated in credit cards, although their growth is constrained by



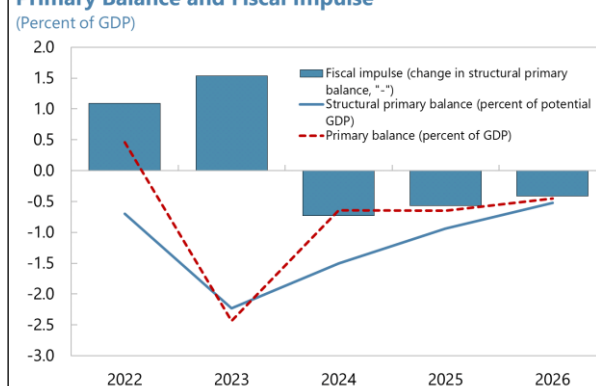
tighter lending standards. The market share of earmarked credit increased slightly in 2023 to about 41.6 percent, while remaining well below the 50 percent level reached in 2016-17.

9. Financial markets have weathered well external stress events. The National Treasury adapted smoothly to periods of volatility in the local yield curve—largely caused by spillovers from the US rates markets—aided by its high level of cash buffers that provide flexibility around issuance plans. External market access remained comfortable. In early 2024, the Treasury took further advantage of market conditions to carry out its largest foreign currency bond issuance, with a volume of US\$4.5 billion and spreads close to the minimum of the last six years.

10. Fiscal policy eased significantly in 2023 but is tightening in 2024. The federal primary

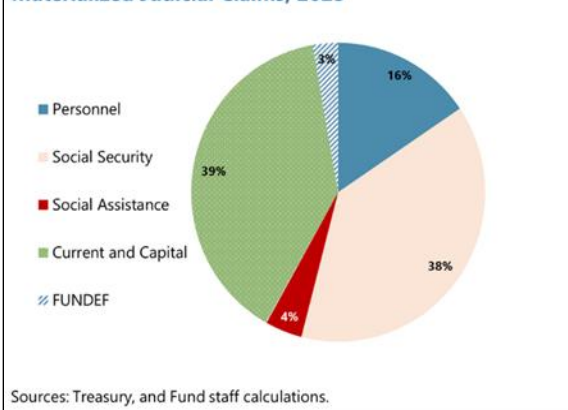
balance declined from a surplus of 0.5 percent of GDP in 2022 to a deficit of 2.4 percent of GDP in 2023, despite a positive output gap and strong commodity revenues, implying a procyclical fiscal impulse. Higher social benefits (1.2 percent of GDP), in line with the new administration's priorities, and extensions of temporary pandemic-related tax cuts pushed up the deficit. The higher fiscal deficit also included the welcome settlement of *precatórios* of 0.8 percent of GDP owed by the central government, covering those recently come due as well as delayed payments from 2022-24. Over half of these payments relate to public wages, social security, and social assistance, directly benefiting households, and are expected to lift consumption in 2024. Abstracting from one-off payments and accounting for the economic and commodity cycle, staff estimates the structural primary balance declined by 1.5 percent of potential GDP in 2023. In 2024, fiscal policy is tightening, supported by revenue measures, with the authorities targeting a zero federal primary deficit. For 2025-26, the 2025 draft Budget Guidelines Law (LDO) submitted to Congress in April lowered fiscal targets for 2025-26 (see below).

Primary Balance and Fiscal Impulse



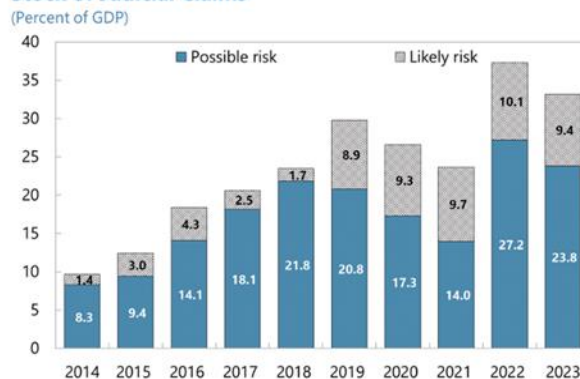
Sources: Treasury, and Fund staff projections.

Materialized Judicial Claims, 2023



Sources: Treasury, and Fund staff calculations.

Stock of Judicial Claims



Sources: Treasury, and Fund staff calculations.

11. The implementation of the 2023 VAT reform is advancing with four complementary laws under congressional discussion. The complementary laws specify: (i) the characteristics of the new dual federal (CBS) and subnational (IBS) VAT system; (ii) the governance structure for the joint revenue administration of the CBS and IBS; (iii) the excise tax regulation; and (iv) administrative processes. These were presented to Congress in April, with approval expected by December.

12. The authorities have made significant progress on Brazil's climate agenda, as part of the Ecological Transformation Plan:²

- With strong law enforcement, supported by additional funding to the Brazilian Institute of Environment and Renewable Natural Resources (IBAMA) under the Ministry of the Environment, and other climate initiatives, deforestation in the Amazon biome fell by half in 2023, implying an estimated reduction in emissions of half a gigaton. This progress was somewhat offset by increased deforestation in the *Cerrado* biome where legal deforestation thresholds are higher.
- The Emissions Trading System (ETS), expected to be approved before August, establishes a mandatory carbon market framework, with a cap-and-trade system that targets emitters releasing more than 25,000 tons of CO₂ equivalent annually, corresponding to around 5,000 companies above the cap, and that would be linked to the voluntary carbon market.³
- Within the voluntary carbon market, the Forest Law approved in May 2023 enables carbon credits and other environmental services in conservation areas, expanding the current credit opportunities, and complementing the mandatory carbon market framework.
- The successful issuance of Brazil's first green and social sovereign bond in November 2023 was a step toward creating a yield curve for green bonds and is expected to be followed by a second issuance later this year. To transition to a low-carbon economy and boost climate finance, the Ministry of Finance, together with the IADB and supported by the BCB, launched in February *ECO Invest Brasil*, a capital mobilization and FX hedging program.
- The BCB sustainability agenda has advanced with the rollout of disclosure requirements of quantitative emission targets expected to start in 2025.
- Brazil's Sustainable Taxonomy, a classification scheme to recognize green corporations and projects, led by the Ministry of Finance with participation of a wide range of public entities, including the BCB, is expected to be operational by mid-2025. It will play a crucial role to define qualification criteria for various climate related instruments.

² The goals of Brazil's [Ecological Transformation Plan](#), launched in 2023, are to boost productivity and generate well-paid green jobs, reduce the economy's environmental footprint, and promote equitable development through better income distribution and benefits.

³ Entities responsible for emissions over 10,000 tons of CO₂ per year will be required to report their emissions.

OUTLOOK AND RISKS

13. Growth is projected to moderate in the near term as inflation converges to target, and then strengthen to 2.5 percent over the medium term—an upward revision from 2.0 percent at the time of the 2023 Article IV Consultation.

- **Growth.** Staff projects a moderation in growth from 2.9 percent in 2023 to 2.1 percent in 2024, reflecting declining but still restrictive monetary policy rates aimed at completing the convergence of inflation to target, a lower fiscal deficit, the normalization of agricultural output from record levels, and the effects of the flood calamity. The projection in 2024 includes a positive 0.3 percentage point contribution from the payment of *precatórios* in late 2023. Growth is then expected to strengthen to 2.5 percent over the medium term, an upward revision of 0.5 percentage point compared with projections in the 2023 Article IV Staff Report. The improvement in growth over the medium term would be supported by fading restrictive cyclical factors (with real interest rates gradually declining to neutral levels) and supportive structural factors, notably the implementation of the efficiency-enhancing VAT reform and the acceleration in hydrocarbon production (see below). The positive estimated gap between actual and potential output is projected to gradually narrow to zero.
- **Inflation and Monetary Policy Stance.** Headline inflation is expected to decline further to 3.7 percent by end-2024 and reach the 3 percent inflation target in the first half of 2026. The BCB policy rate is expected to approach its estimated neutral level in 2026, with short-term real interest rates in the 4.5 to 5.0 percent range.
- **Fiscal Balance and Government Debt.** Staff expects the federal primary deficit to narrow from 2.4 percent of GDP in 2023 to 0.6 percent of GDP in 2024 and 0.7 percent of GDP in 2025 before gradually rising to a surplus of 1 percent of GDP in 2029 and 1.5 percent of GDP over the extended policy horizon, contingent on the implementation of measures. General government gross debt is projected to stabilize at around 95 percent of GDP over the extended policy horizon.⁴
- **Current Account.** The current account deficit is expected to widen to 1.8 percent of GDP in 2024 and remain around 1.5 percent of GDP over the medium term. The decline in medium-term current account deficits of 0.5 percentage points, compared with previous projections, reflects the stronger trade balance driven by structural factors such as increased oil exports, and upward revisions in nominal GDP. Current account deficits are projected to be financed by FDI inflows, including in the expanding hydrocarbon sector (see Annex II).

⁴ The IMF staff definition of public sector debt corresponds to general government gross debt. Unlike the authorities' definition, the IMF staff definition comprises treasury bills on the central bank's balance sheet not used under repurchase agreements. The upward revision to medium-term growth outlook reduces the debt-to-GDP ratio in 2030 by about 2 percentage points, holding other factors unchanged.

14. The balance of risks to the growth outlook has improved since the 2023 Article IV Consultation but remains somewhat tilted to the downside, while uncertainty remains.

Downside risks to growth have subsided since the 2023 Article IV consultation, amid resilient economic activity, falling inflation, and the approval of the landmark VAT reform. There is also scope for further positive growth surprises (see Risk Assessment Matrix in Annex V).

- **Downside Risks.** On the external front, downside risks include a slower-than-expected decline in core inflation in major advanced economies that leads financial markets to revise up their interest rate expectations and puts pressure on the borrowing costs and currencies of emerging market economies. An abrupt global slowdown, in particular in Brazil's major trading partners such as China and the US, could weaken exports and growth. Monetary policy miscalibration in major central banks and commodity price volatility also pose downside external risks. On the domestic front, supply disruptions from the 2024 flood calamity could be more severe than currently expected. Estimates of the impact are still uncertain, including for growth and the fiscal balance. In addition, a lower-than-envisaged fiscal effort could reduce policy credibility and increase policy uncertainty, resulting in higher borrowing costs and weaker investment. It would also increase risks of de-anchoring inflation expectations.
- **Upside Risks.** In the near term, domestic upside risks to growth include stronger-than-expected household consumption in the context of a still-tight labor market and higher real household income, although this could entail positive inflation surprises and a tighter monetary stance. On the structural side, a faster-than-expected implementation of reforms entails upside risks. Investment in green growth opportunities could further boost economic potential. With a relatively high share of jobs susceptible to artificial intelligence (AI) compared to other economies in the region, Brazil's growth also stands to benefit from the rollout of AI and enhancements to worker productivity, although AI integration could also lead to job obsolescence in some professions (Box 1). External upside risks include greater-than-envisaged fiscal support in major economies in the context of elections in 2024 (see IMF April 2024 WEO).
- **Buffers and Resilience Factors.** A sound financial system, adequate FX reserves, low reliance on FX debt, large government cash buffers, and a flexible exchange rate continue to support Brazil's resilience.

Authorities' Views

15. The authorities broadly shared staff's views on the near-term outlook and welcomed the upward medium-term growth revision. They noted that drivers of Brazil's growth resilience have included robust consumption in the context of a tight labor market with rising real incomes, minimum wage increases, and lower household debt vulnerabilities supported by the *Desenrola* program. They agreed with staff's assessment on the balance of risks in the near term but emphasized that the macroeconomic effects of the floods in *Rio Grande do Sul* remain uncertain with the possibility that reconstruction efforts could raise economic activity in the second half of 2024. The authorities agreed with staff's assessment of the drivers of medium-term growth that supported an upward revision. They viewed the Ecological Transformation Plan as contributing to

stronger, greener, and more sustainable and inclusive growth. The BCB concurred that inflation had declined with the fading of earlier relative price shocks as well as the proactive and decisive monetary policy action and communication. They agreed with staff on their analysis of possible factors leading to above-target inflation expectations but saw uncertainty as likely to fade in the context of the still restrictive policy rates and the expected reduction in the fiscal deficit. The authorities agreed with staff that the 2023 external position was broadly in line with the level implied by fundamentals and desirable policies and that higher hydrocarbon output entailed a structural improvement over the medium term.

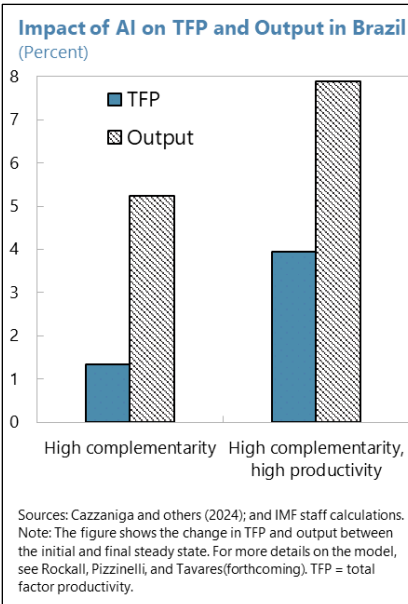
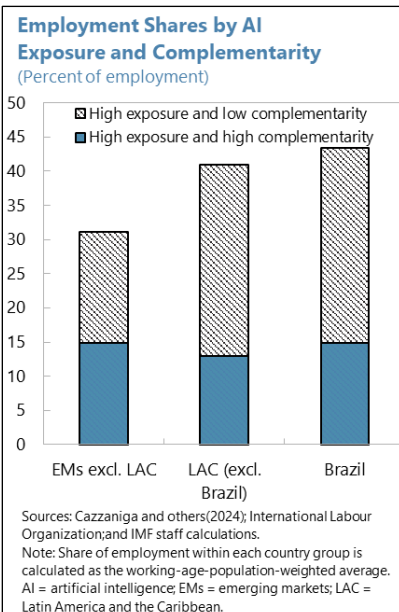
Box 1. Potential Impact of Artificial Intelligence on Brazil's Productivity and Output

AI stands at the forefront of a transformative wave, although its economic and social consequences are not yet fully understood. IMF staff analysis assesses AI's influence on productivity and the labor market based on the concept of AI exposure (Felten, Raj, and Seamans 2021, 2023) and AI complementarity (Pizzinelli and others 2023).

Approximately 45 percent of jobs in Brazil are estimated to be exposed to AI. Brazil's overall exposure to AI is greater than other emerging market economies (based on estimates by Cazzaniga and others 2024). AI is expected to enhance productivity in over one-third of these exposed jobs (about 15 percent of all jobs). Women are better positioned to experience productivity gains than men. The share of women in Brazil in occupations susceptible to AI is more than 20 percentage points larger than that of men; this difference reflects their average higher educational attainment and presence in professional and clerical occupations with high exposure and complementarity to AI. For about 30 percent of all jobs, AI integration could automate tasks, potentially reducing labor demand and wages and even leading to job obsolescence.

A model-based analysis is used to gauge AI's potential impact on productivity and output. In the model, AI affects productivity through three critical channels: (i) labor displacement; (ii) AI complementarity with skills; and (iii) productivity gains. First, AI adoption may shift tasks from humans to AI-driven systems, enhancing the efficiency of task completion. Second, AI integration could benefit tasks that are highly complementary to AI. Third, AI adoption may lead to broad-based productivity gains, boosting investment and increasing overall labor demand.

For Brazil, AI adoption is estimated to raise output by about 5 percent based on the model analysis, although the impact of AI remains highly uncertain. The economy would adjust to the new steady state through a combination of capital deepening and higher total factor productivity (TFP), driven by the substitution of tasks from labor to capital and under the assumption that capital is more effective at executing tasks, following Moll, Rachel, and Restrepo (2022). However, when an additional productivity impact is also considered, with AI supporting performance of workers and capital in all tasks, output expands by nearly 8 percent and TFP increases by



Box 1. Potential Impact of Artificial Intelligence on Brazil's Productivity and Output (concluded)

almost 4 percent. These gains happen primarily in the first decade of transition. Incomes for all workers increase, with greater gains estimated for initially high-income workers, implying greater income inequality. In the near term, the rollout of AI could also boost business investments into innovative tools and refining production processes. At the same time, the economic impact of AI, as well as its timing, remains uncertain. Existing studies come with a range of estimates; e.g., for the United States, Briggs and Kodnani (2023) find large effects on productivity, while Acemoglu (2024) finds smaller effects.

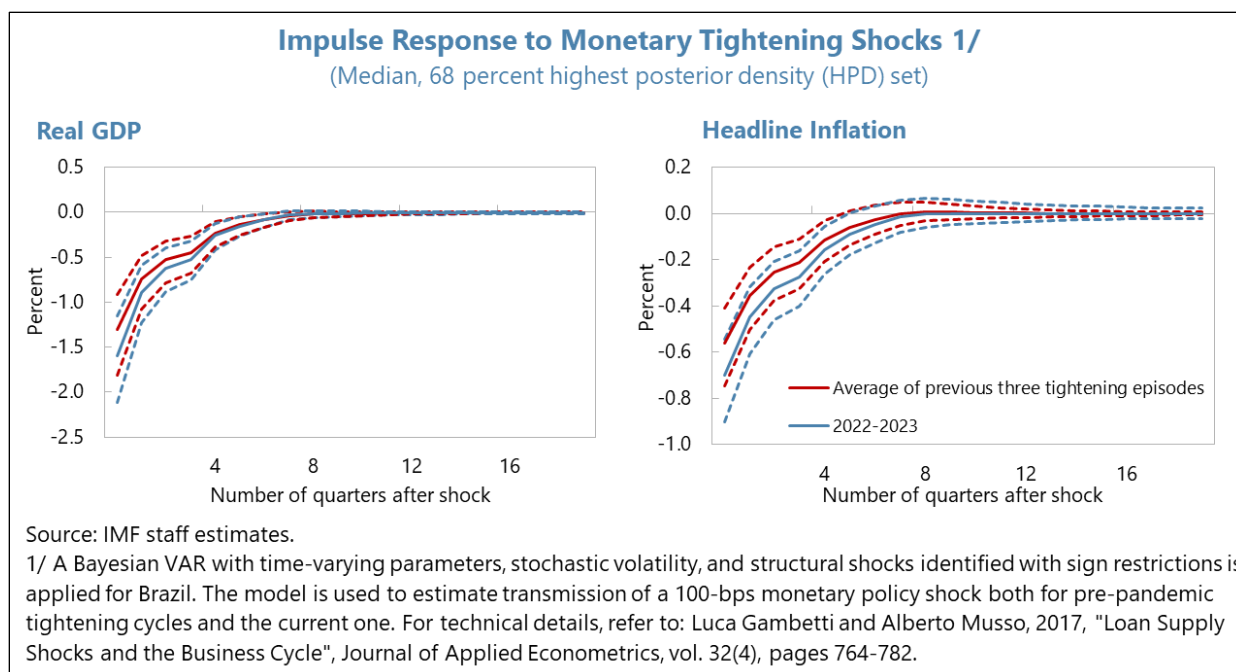
POLICY DISCUSSIONS

A. Guiding Inflation and Expectations Back to Target

16. The pace of policy rate reductions since August 2023 has been appropriate and consistent with the inflation targeting framework. The 325-basis point reduction in nominal policy rates so far to 10.50 percent in May is estimated to have reduced real policy rates while appropriately keeping them in restrictive territory. The BCB initial guidance of cuts of 50 basis points per meeting effectively steered market expectations, including through turbulence in global bond markets. Medium-term inflation expectations have remained at about 50 basis points above target, possibly reflecting uncertainties over the fiscal consolidation path as well as the composition of the BCB Board of Governors after the terms of three out of nine members expire in December 2024 (in line with the Central Bank Autonomy Law of 2021).

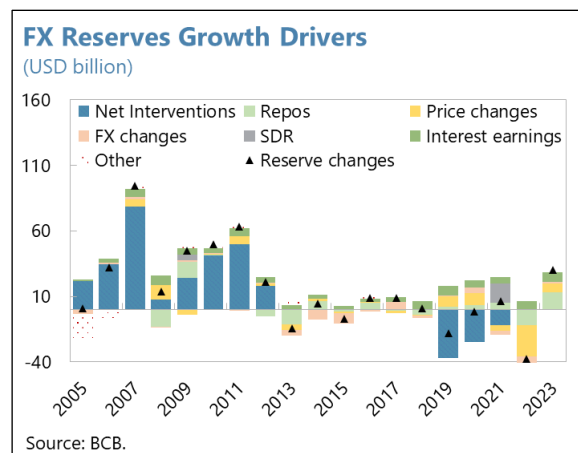
17. As disinflation proceeds, with inflation projected to remain within the target tolerance interval, maintaining flexibility on the pace and length of the easing cycle is prudent given continued labor market resilience and inflation expectations above target-consistent levels. The BCB's policy stance and clear commitment to the 3 percent target bodes well for the further decline in inflation expectations, conditional on continued credibility of both fiscal and monetary policy frameworks. Contingent on underlying inflation data and inflation expectations anchoring around the 3 percent target, a path for the policy rate that approaches its neutral level in 2026 would be prudent.

18. Monetary transmission has been effective and broadly in line with previous tightening episodes, notwithstanding structural transformation in the financial sector. Staff estimates using a Bayesian VAR model show no clear evidence of a change in monetary policy transmission to output and the CPI compared to past tightening episodes. Moreover, Phillips curve estimates suggest that the relationship between the output gap and inflation has remained largely unchanged compared with the pre-pandemic period (Annex IV). As discussed at the time of the 2023 Article IV Consultation, the decision in June 2023 by the National Monetary Council to adopt of a continuous 3 percent target from 2025 onwards has reduced uncertainty and strengthened monetary policy effectiveness.

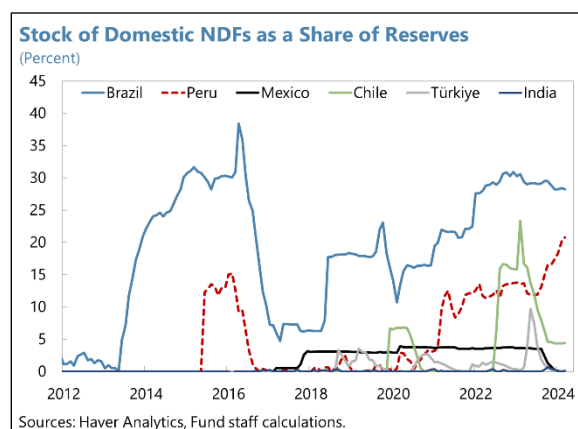


19. The flexible exchange rate regime and adequate FX reserves remain valuable shock

buffers. Brazil continues to retain a comfortable net creditor status on external debt that acts as an insurance against a tightening of the global financial cycle. Given continued risks from an abrupt tightening of global financial conditions and narrowing interest rate differentials with advanced economies, maintaining exchange rate flexibility is instrumental to absorb shocks. FX intervention could be used to address episodes of higher risk premia when FX liquidity becomes shallow but should not substitute for warranted adjustment of macroeconomic policies. With around US\$350 billion in FX reserves, reserve adequacy remains well within adequate ranges (130 percent of the IMF ARA metric as of end-2023), with a notable improvement in 2023 largely due to the wind down of the FX repo stock, interest earnings, and price changes. There was also no spot intervention in 2023.



20. When market conditions are conducive, reducing the stock of outstanding FX swaps would create additional policy room for maneuver. The presence of the BCB in the onshore



non-deliverable market through FX swaps has been stable at around US\$100 billion over the last few years, with the objective of ensuring smooth functioning in both spot and derivatives markets. While there is no well-established limit for FX swaps interventions, reducing the stock of outstanding FX swaps when market conditions are conducive can increase policy space for ensuring smooth market functioning in the event of future shocks.

21. Staff advised the authorities to continue reducing the financial transaction tax (IOF-FX) to zero as planned. The longstanding tax on certain financial transactions (*Imposto sobre Operações Financeiras*, IOF) gives rise to a multiple currency practice (MCP), which is also an exchange restriction as the effective exchange rate of exchange transactions subject to the IOF-FX exceeds the permissible margin from February 1, 2024, under the Fund's new MCP policy.⁵ The IOF tax increased transaction costs for FX transactions, with limited impact on FX liquidity. The gradual reduction path of the IOF-FX tax beginning in 2022 to ultimately a zero rate by 2029 will eliminate the MCP and exchange restriction, and is predetermined and well communicated, with limited economic impact.

Authorities' Views

22. The authorities agreed that monetary policy is consistent with reducing inflation to target. The BCB remains firmly committed to the inflation targeting framework and agreed with staff that maintaining flexibility on the pace and length of the easing cycle is appropriate at the current stage of the disinflation process. They underscored the importance, as inflation converges to target, of closely monitoring a range of metrics of underlying inflation and inflation expectations, and of calibrating policies to incoming data. They reiterated their commitment to exchange rate flexibility. The BCB highlighted that their strategy on FX swaps considered spot and forward market conditions in tandem to reduce the cost of carry, while a positive stock of swaps was needed to preserve market functioning. They agreed that the IOF-FX tax increased transaction costs of FX transactions and confirmed that the gradual reduction path that began in 2022 aiming to bring the IOF-FX tax to zero in 2029 is predetermined and well communicated, with little economic impact.

B. Safeguarding Financial Stability while Promoting Financial Inclusion and Innovation

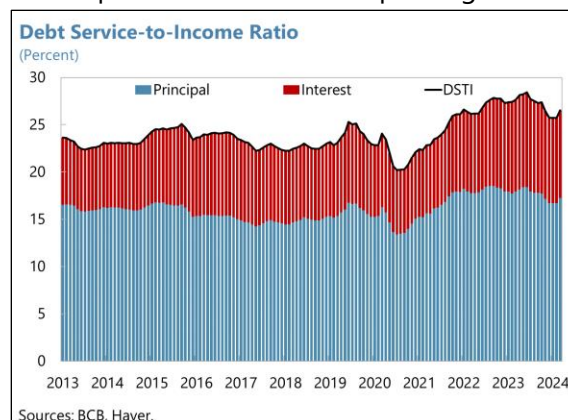
23. The financial system remains resilient and systemic risks are contained. Banks are highly liquid, with liquidity coverage ratios well above the regulatory minimum reaching 185 percent at end-2023. Banks are also adequately capitalized, with a CET1 capital ratio of 14.8 percent at end-2023. Asset quality and profitability improved in the second half of 2023 as household balance sheets and economic conditions strengthened. Provisions remain well above expected losses. The

⁵ The IOF tax is applied on exchange transactions carried out through credit card, debit card, and traveler's checks (including cash withdrawals) by companies to fulfill their payment obligations for purchases of goods and services abroad by their customers. It has been further reduced to 4.38 percent in January (and from an original 6.38 percent to 5.38 percent in January 2023). In March 2022, Brazil's Executive Branch published Presidential Decree 10.997/2022 that will gradually reduce the IOF-FX rates on all eligible FX settlements to zero percent by 2029.

authorities' latest stress tests continue to underscore the banking sector's resilience to credit, market, fiscal deterioration, liquidity shocks, and climate shocks. Risks from the growing non-bank financial institutions (NBFIs) are contained: stress tests indicate that the step-in risk stemming from investment funds has halved since 2022 and the BCB is taking welcome steps to strengthen oversight of NBFIs, including a new prudential framework for conglomerates composed of payment institutions that specifies the methodologies for calculating regulatory capital and capital requirements. The risk of an adverse bank-sovereign nexus is mostly alleviated by banks' appropriate interest-rate risk management and BCB prudential measures.

24. Credit risks related to micro and small enterprises warrant close monitoring. After the bankruptcy of a large retailer in January 2023, risk materialization among large companies has come down, in part helped by improvements in the domestic capital market. Problem assets in micro and small enterprises have stabilized amid economic recovery but remained at high levels at end-2023 in the context of still restrictive monetary policy rates. Looking ahead, debt servicing capacity for all corporates is expected to improve with real interest rates gradually declining and robust economic activity. The authorities are also reallocating existing budgetary resources to a package of credit support measures for micro and small enterprises.

25. The authorities have taken welcome steps to address households' debt burden. The household debt service-to-income (DSTI) ratio eased to 26.5 percent in March after peaking at 28.4 percent in June last year. Non-performing loans (NPLs) have declined with banks adopting more conservative standards in granting credit cards and non-payroll deducted credits. Housing prices have been resilient to higher interest rates, and NPLs on mortgage loans remain low (under 2 percent). The strengthening in household balance sheets reflects favorable employment and income dynamics as well as policy initiatives, most notably the *Desenrola* program that helped over 15 million people renegotiate about R\$50 billion (about 0.5 percent of GDP) in overdue debt (Box 2). The current macroprudential stance is broadly appropriate. Given the high credit cost of consumer loans, the authorities should closely monitor household DSTI and NPLs and consider applying a DSTI limit when necessary, complementing existing supervisory and prudential measures.



Box 2. Measures to Improve Household Financial Health

Household financial health has emerged as a concern in Brazil amid the rapid expansion of access to credit. As of end-2023, more than 40 percent of consumers in Brazil had defaulted on some form of debt, such as credit cards, utility bills, or other loans. The overall DSTI ratio declined after peaking at 28 percent in June 2023, but remains above its pre-pandemic level. High household debt can lower consumption and stunt growth (see [IMF, April 2022, WEO](#), Chapter 2).

Box 2. Measures to Improve Household Financial Health (concluded)

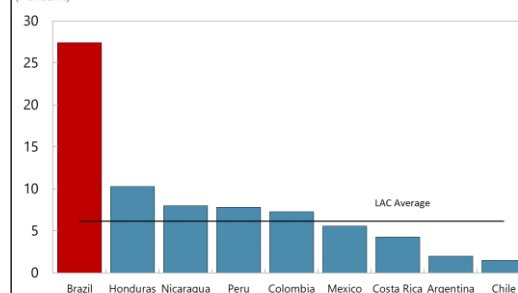
There are a few contributing factors to household financing burdens. First, the cost of credit is high—the interest rate spread in Brazil is higher than that in regional peer economies. Second, financial literacy is relatively low, especially among new credit cardholders who tend to be less informed about the terms of their credit card debt. And third, many households have very little wealth and rely on credit during economic downturns—for example, the debt-to-income ratio rose by 8 percentage points during the pandemic.

The government has taken welcome measures to improve household financial health, notably via its flagship program *Desenrola Brasil*. This program, implemented from July 2023 to May 2024, aimed to assist households in default to regain access to credit. In the first stage of the program, creditors participated in an auction and those that offered the largest discounts in debts became eligible for the program. In the second stage, low-income borrowers were able to consolidate and settle their debts on the *Desenrola* platform or through post offices. Borrowers could pay upfront or refinance with a new bank loan of up to 60 months. Refinancing of up to R\$5,000 per borrower was guaranteed by the government, with a total budget envelope of R\$8 billion (less than 0.1 percent of GDP).

The innovative design of the *Desenrola* program enabled the achievement of its goal with minimal fiscal risks. The program was well targeted: only borrowers with a monthly income equivalent of up to two minimum wages were eligible. The program also incentivized buy-in from private sector creditors. More than 600 financial and non-financial sector creditors participated in the auction and offered discounts averaging 83 percent, higher than the rates offered in private debt renegotiations. Although the program ended in May 2024, it provides the infrastructure for potential future debt renegotiation between consumers and private creditors. The platform also promotes financial education to prevent future indebtedness.

Additional steps have included launching a comprehensive financial literacy campaign, improving transparency rules for credit card lending, and establishing a limit on credit card charges. The authorities have put in place a limit on credit card interest and fee charges of 100 percent of the original amount. Such a cap could curb excessive interest rate costs for households for which the limit is binding, but possible negative implications for the quantity and quality of credit need to be carefully assessed.

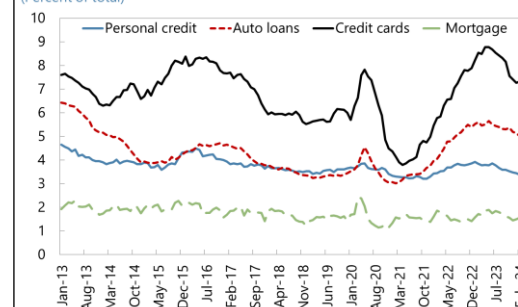
Interest Rate Spread (Lending-Deposit) 1/ (Percent)



Sources: IMF, IFS, WB.

1/ The terms and conditions attached to these rates may differ by country, limiting their comparability.

NPLs on Loans to Households (Percent of total)



Source: BCB.

26. The authorities' ongoing reform efforts aimed at lowering credit costs, based on a sound diagnosis, are welcome. Although recent financial innovation has reduced transaction costs and facilitated competition, interest rate spreads remain above 20 percent. A large part of the spread is attributable to structural challenges in the credit market, including inefficient collateral enforcement, low debt recovery ratios, and margins of financial institutions. The government is aware of these challenges and established a new secretariat for economic reforms in 2023 to advance regulatory reforms, including to increase financial market competition and improve the

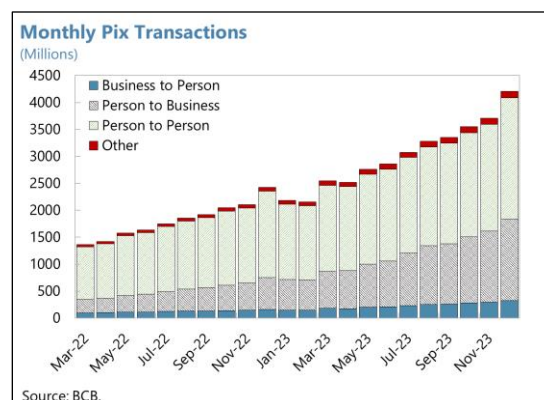
recovery of delinquent loans. Sustaining these reform efforts would reduce costs and distortions and enhance the efficiency of credit allocation to support competition and productivity across economic sectors.

27. Lending by public banks to specific sectors can be warranted in the presence of well-established market failures, subject to minimizing distortions to the private credit market.

Since a set of reforms in 2017, the funding cost to public banks has transitioned from a subsidized rate (TJLP) to a rate that reflects the cost of government funding (TLP). At present, public banks are well-capitalized, profitable, and liquid, and have been paying dividends and pre-paying (mainly the Brazilian National Development Bank, BNDES) liabilities to the government. The government plans to invest in specific sectors through the BNDES. Continued careful management of a bigger role for public banks is needed to mitigate any potential risks to the fiscal position, monetary policy transmission, and market efficiency. Ongoing initiatives to issue loan guarantees and on-lending to private banks to resolve well-established market failures are appropriate.

28. The BCB remains at the forefront of financial innovation amid internal resource constraints.

The expanding financial innovation agenda has promoted financial inclusion, efficiency, and competition.⁶ Most notably, the adoption of the instant payment system *Pix* has continued to exceed expectations and has made Brazil a global leader in terms of transactions per capita. However, the development of new *Pix* functionalities, such as automatic payments and cross-border payments, has been delayed in the context of BCB resource constraints, notably on the staffing side. Building on past reforms on BCB autonomy, providing the BCB with additional flexibility to cover operating expenses would allow it to attract and retain the professional talent necessary for contributing to financial innovations in the context of an evolving financial ecosystem and sustainable finance initiatives, while ensuring effective accountability mechanisms and cyber security.



29. The BCB is working on overcoming privacy and governance challenges to realize the potential of the flagship CBDC initiative *Drex* to “tokenize the economy.” *Drex* aims to underpin an interoperable public blockchain infrastructure that facilitates innovative financial services within a regulated environment. From its early stages, *Drex* is expected to demonstrate the benefits of “tokenizing the economy” by easing access to credit for borrowers that hold tokenizable collateral (for example, government bonds) and encouraging new entrants of financial service providers. A number of technological and legal challenges remain to be addressed before *Drex* becomes operational. Most notably, the latest *Drex* pilots have highlighted the technical difficulty of offering scalable token-based financial services while ensuring compliance with Brazil’s data

⁶ IMF, 2023, *Brazil: Selected Issues, Country Report No. 2023/289*.

protection and bank secrecy laws. The BCB is also looking at the rules and mechanisms that govern smart contracts and discussing user cases with the market.

Authorities' Views

30. The authorities concurred that the financial sector remains resilient and that systemic risks are contained. They expected credit risks in the household sector to improve and agreed that risks in micro and small enterprises warrant close monitoring. The authorities did not currently see a need for a limit on the debt service-to-income ratio. They pointed out that supervisory action, timely monitoring and, when needed, the set of macroprudential measures used in past credit cycles had proven effective at containing risks. That said, the authorities considered that limits on debt-service-to-income were in their toolkit and could be used in the future if needed. The authorities were not concerned about risks from non-bank financial institutions or the sovereign-bank nexus, citing robust prudential measures and contagion analysis results. They noted that most of the loans of the largest public bank (BNDES) are at market rates and fill gaps in private financing of infrastructure and long-term projects. They highlighted ongoing reform efforts to reduce credit costs, including by strengthening the legal framework for bankruptcy, guarantees, capital markets and resolution. They underscored the importance of covering operating BCB expenses in a way that would allow the BCB to continue contributing to financial innovations and sustainable finance initiatives, while ensuring effective accountability mechanisms and cyber security. They aimed to launch the *Drex* platform in 2025 but noted the need to address privacy issues before opening the platform to the public.

C. Securing Fiscal Sustainability and Revamping Taxation

31. The authorities' commitment to continue improving the fiscal position is welcome. In the 2025 draft Budget Guidelines Law (LDO) submitted to Congress in April, the government reaffirmed its commitment to the zero primary deficit target for 2024 while lowering the targets for 2025-26 (Box 3), within a narrow (± 0.25 percentage point of GDP) tolerance band. The indicative target path was also extended to 2028, allowing for a welcome broader medium-term perspective. For 2025, the draft LDO proposed a zero federal primary deficit target, excluding 0.3 percent of GDP of *precatórios*. For subsequent years, the LDO proposed an indicative target path that rises to a surplus of 1.0 percent of GDP by 2028.⁷ The authorities envisage additional adjustment over the longer term to a primary fiscal surplus of 1.7 percent of GDP.⁸ Based on more favorable macroeconomic assumptions than staff, notably on interest rates, the authorities estimate that the revised fiscal targets would stabilize public debt (authorities' definition) by 2028 followed by a gradual decline in subsequent years. The authorities intend to rely on a more balanced mix of additional revenues and expenditure rationalization and have recently introduced limitations on tax credits for federal PIS/COFINS taxes to compensate for extension of payroll exemptions ahead of the 2025 Budget to be submitted to congress in August. The authorities' intention to pursue a strategy

⁷ For 2025, the draft LDO foresees a federal primary deficit of 0.23 percent, of which 0.32 percentage point of GDP relates to the payments of *precatórios*. The latter are excluded from the target from 2025 onward.

⁸ See the fiscal outlook for the next 10 years published in the National Treasury's Fiscal Outlook Report.

entailing both expenditure and revenue measures is welcome. Staff estimates that meeting the authorities' targets would require additional measures amounting to 0.7 percent of GDP in 2025 and 1.3 percent of GDP by 2028. The authorities' intention to continue enhancing fiscal data quality is welcome (Annex VI).

Box 3. Recent Revisions to Brazil's Fiscal Framework

Spending corridor established in 2023. The constitutional amendment approved in August 2023 replaced the cap of zero growth in federal real spending that had been in force since 2016 with a corridor for federal real spending growth with a floor of 0.6 percent and a ceiling of 2.5 percent, contingent on revenue collection and the distance to a primary balance target. Concretely:

- If the primary balance in year t is within the band, planned real federal spending growth in year $t+2 = 0.7 \times$ real revenue growth in $t+1$ (mid-year).
- If the primary balance in year t is outside the band, planned real federal spending growth in year $t+2 = 0.5 \times$ real revenue growth in year $t+1$ (mid-year).

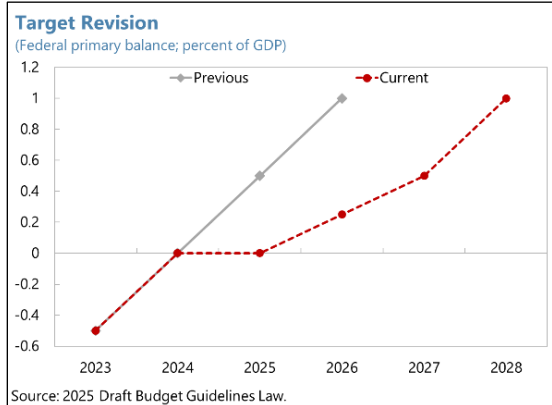
With the removal of the 2016 spending cap, education and health spending floors (provisioned by ordinary laws) became binding again. The 2023 amendment also established a new floor on public investment of 0.6 percent of GDP. Up to 70 percent of the overperformance of the primary balance relative to target can be used towards higher capital spending, with a limit of 0.25 percent of previous year's GDP.

Spending base adjustments. In late 2023, payments of *precatórios* were taken out of the base of the spending corridor for 2025 and 2026.¹ The recent declaration of a state of calamity in *Rio Grande do Sul* allows for registering any flood-related emergency support under extraordinary credits in 2024, which are also excluded from the base of the spending corridor. For 2024, expenditures of R\$15bn, which were provisioned for the second half of 2024 under the condition that the projected revenue growth would materialize, were advanced to May.

Revised indicative federal primary balance path. The spending corridor established in 2023 was complemented by an indicative primary balance path improving from a deficit of 0.5 percent in 2023 to a surplus of 1 percent of GDP in 2026, within a tolerance band of ± 0.25 percent of GDP.

The 2025 draft LDO proposed a zero-deficit target for 2025 (revised down by 0.5 percentage point of GDP), that will be binding for the preparation of the 2025 Budget, and indicative targets for the federal primary balance with surpluses of 0.25 percent of GDP for 2026 (down from 1.0 percent of GDP), and 0.5 percent of GDP and 1.0 percent of GDP for 2027 and 2028, respectively.

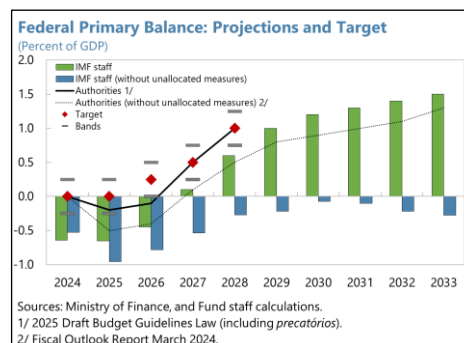
As before, the target can in principle be revised throughout the year with a simple parliamentary majority. Within-year correction mechanisms continue to apply, including bans on new hiring, increases in public wages, new mandatory spending, social assistance policies, or tax benefits if the primary balance target is assessed to be at risk within the year.



1/ For further details on the fiscal rule, see [IMF, 2023. Brazil: Selected Issues, Country Report No. 2023/289](#).

32. Staff's baseline scenario is consistent with a more gradual fiscal improvement.

- For 2024, staff projects a federal primary deficit of 0.6 percent of GDP, narrowing from a deficit of 2.4 percent of GDP in 2023. Abstracting from one-off factors, the structural primary balance is projected to improve by about 0.7 percentage point of potential GDP. Identifying additional measures at this stage of the budget cycle may be challenging to meet the 2024 zero-deficit target. Approved tax measures are expected to increase revenue by 1.1 percent of GDP in 2024. At the same time, the contribution from tax debt renegotiations and other efforts are falling short of initial estimates and spending demands are increasing, including in social security spending due to a higher minimum wage and an expansion in the number of beneficiaries. Planned emergency spending for *Rio Grande do Sul* is estimated at 0.2 percent of GDP, with an additional 0.2 percent of GDP in (below the line) reprofiling of state debt owed to the federal government.
- For 2025, staff projects a federal primary deficit of 0.7 percent of GDP, predicated on additional (currently unallocated) measures of 0.3 percent of GDP. For subsequent years, staff's baseline scenario foresees a gradual fiscal effort leading to a primary surplus of 1.5 percent of GDP in 2033. The projection assumes an increase in commodity-related revenues associated with the expanding hydrocarbon sector,⁹ a moderation in spending growth guided by the fiscal rule, and the implementation of additional (currently unallocated) measures amounting to 1.6 percent of GDP drawing on the authorities' intention to broaden the tax base, including by tackling tax expenditures, and streamline expenditures, including by improving spending efficiency.¹⁰ With this baseline path for the primary fiscal balance, general government gross debt is projected to stabilize at around 95 percent of GDP in 2032 (Annex VII).



33. Staff recommends a sustained and more ambitious fiscal effort that puts public debt on a firmly downward path and opens space for priority investments. Staff's debt sustainability assessment finds risks of debt distress to be moderate under the baseline scenario, but the debt trajectory remains highly sensitive to shocks to borrowing costs and real GDP growth and the materialization of contingent liabilities (Annex VII). The overwhelmingly domestic investor base, low external debt, and large cash buffers by the public sector mitigate risks and provide room for fiscal consolidation to proceed gradually over the medium term. Staff's assessment suggests that Brazil has some fiscal space to respond to temporary shocks. Guided by a buffer analysis around optimal debt anchors, staff recommends a path for the primary fiscal balance that starts with achieving the

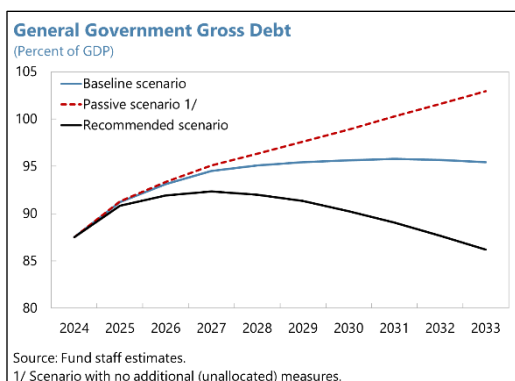
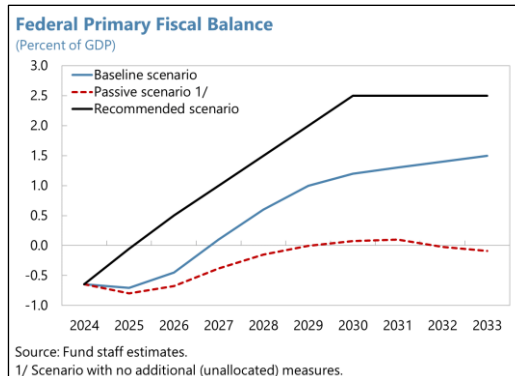
⁹ The expected expansion in hydrocarbon output is mainly driven by private companies. Additional revenues would therefore be collected in form of royalties and corporate income tax (not additional dividends from Petrobras as in previous commodity booms).

¹⁰ Staff's baseline scenario envisages a 0.1 percent of GDP deficit for subnational governments in 2024 and 2025, and a broadly balanced fiscal position thereafter; hence, also a general government primary balance of 1.0 percent of GDP by 2029.

zero-deficit target in 2025, followed by improvements of 0.5 percentage point of GDP per year, resulting in a primary fiscal surplus of 2.5 percent of GDP by 2030.¹¹ Such fiscal path would put general government gross debt on a firmly downward trend, improve sovereign financing conditions, strengthen the anchoring of inflation expectations around the 3 percent target, and increase space for productivity-enhancing investments, including for resilient infrastructure. Building on the 2023 fiscal rule and in line with recommendations of the 2023 Article IV Consultation, an enhanced fiscal framework with a medium-term debt anchor, stricter provisions that ensure consistency between the spending corridor and fiscal targets, and mechanisms to limit procyclicality would support credibility and sustainability.

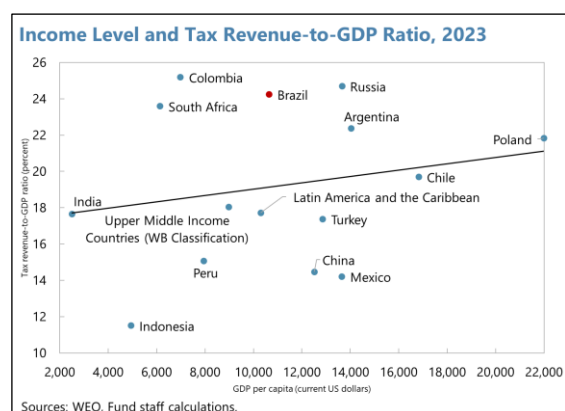
34. The adjustment could include further steps toward generating revenues, building on the authorities' achievements.

Focusing on the elimination of inefficient tax expenditures, estimated at 4-5 percent of GDP, and broadening the tax base by closing loopholes is appropriate.¹² Reforming the PIT, including the taxation of dividends, could generate additional revenues and increase progressivity. Any increases in the personal exemptions threshold for the PIT, currently exempting about 80 percent of the population, should be cautiously weighed against increasing marginal PIT rates for higher-income brackets and phasing



| Federal Tax Expenditures by Program Category (Percent of GDP) | |
|---|------------|
| | 2023 |
| <i>Simples Nacional</i> (SME) | 1.1 |
| PIT deductions and exemptions | 1.0 |
| CIT sectoral and regional incentives | 0.5 |
| Non-profit organizations | 0.4 |
| Basic food exemption | 0.4 |
| Manaus Free Trade Zone | 0.3 |
| Medicine and medical equipment | 0.2 |
| Other tax expenditures | 0.4 |
| Total | 4.3 |

Source: IMF, 2023, Brazil: Selected Issues, Country Report No. 2023/289.



¹¹ See detailed recommendations in [IMF, 2023, Brazil: Selected Issues, Country Report No. 2023/289. The special tax treatment of Manaus could be maintained on a temporary basis under the VAT reform with strong incentives to phase it out.](#)

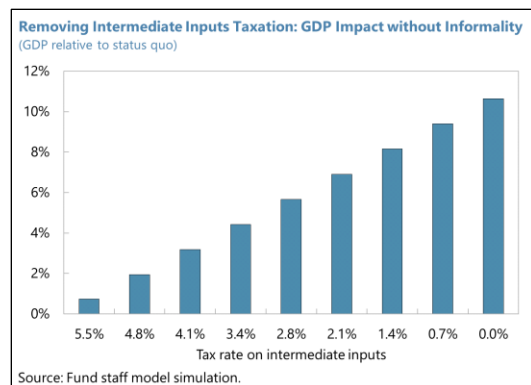
¹² See Coelho, M.D. 2021. "Brazil: Tax Expenditure Rationalization within Broader Tax Reform." IMF Working Paper No. 2021/240. Washington: International Monetary Fund.

out or capping deductions for health and education to generate additional revenues on balance. A concomitant reform of SIMPLES would discourage PIT avoidance through incorporation.

35. Tackling spending rigidities remains a priority. Spending reforms are needed to control continued spending pressures that, if left unchecked, will make compliance with the spending rule difficult in the coming years. Spending reviews of pension and social programs are underway, aiming to create space for new initiatives. Using part of the identified space to reduce the overall spending envelope would support achieving the authorities' fiscal consolidation path. Staff welcomes considerations on de-indexing spending items from minimum wage increases and reforming the education and health floors that came back into force in 2024. To restrain increases in mandatory spending, priorities include public administration reform to reduce wage premia between (federal) public and private sectors and review career paths; pension reform to align special regimes to the reformed general system (RGPS) and ensure longer-term sustainability; and seeking efficiencies in social programs while ensuring continued targeted support for vulnerable households.¹³ Savings from such reforms would accrue over the medium term, strengthening the case to start implementation in the near term.

36. The VAT reform is expected to boost productivity and improve equity of the tax system, and efforts are rightly directed toward ensuring its effective implementation. The

reform tackles deep efficiency problems in Brazil's indirect tax regime. It merges five taxes over three levels of government into a dual VAT and an excise tax (Box 4). By removing inefficiencies, notably the incomplete crediting of taxes paid on intermediate inputs, staff estimates that the reform will lift output by 6-11 percent, depending on assumptions about informality (which would dampen the output impact) and considering full implementation (Annex VIII). The reform would also foster formal job creation. The reform is expected to make consumption taxes less



regressive through the introduction of a cashback system, a shift in the tax burden from goods to services, and lower statutory rates. To amplify equity gains, the cash back system could be expanded, and the planned exemptions and reduced rates limited, also generating fiscal savings. To ensure smooth implementation during the transition phase (2026-2033), governance and operational challenges would need to be addressed, including by integrating management of CBS-IBS; fully refunding excess credits on a timely basis; and harmonizing revenue administrations to leverage synergies across levels of government and enable the implementation of a single, risk-based compliance strategy.

37. The authorities' goal of ensuring that the VAT reform is revenue neutral is welcome and requires efforts to mitigate downside revenue risks. Revenue losses could arise due to: (i)

¹³ See [IMF, 2023, Brazil: Selected Issues, Country Report No. 2023/289](#).

lower statutory rates¹⁴ in sectors that currently face higher tax burdens than others (for example, manufacturing, communications, and IT); (ii) frictions in increasing statutory rates, for instance due to special tax regimes in lower-taxed sectors (notably services); (iii) challenges in bringing the informal sector into the tax base; and (iv) the reduction in revenues currently raised from intermediate inputs absent a complete shift in the tax base from producers to consumers (Annex VIII). During the transition, a yearly correction mechanism to ensure revenue neutrality allows for some space to raise the reference rate for all three levels of government. Resources were committed by the federal government for the capitalization of five funds for compensating states for possible revenue losses given expected changes in revenue collection across regions (0.7 percent of GDP), the continuation of certain tax benefits that have already been granted by states (1.5 percent of GDP), and the recognition of accumulated legacy tax credits under the old system,¹⁵ none of which are considered under staff's baseline. With significantly better compliance due to simplification, stringent e-invoicing, and harmonized systems, the authorities expect the tax gap (the difference between actual and potential tax collection) to decline from the current estimated level of 22 percent for the federal PIS/COFINS taxes to around 10 percent. Remaining revenue gaps could be mitigated through temporarily limiting exemptions and reduced rates. Over the longer term, gains from stronger GDP would further mitigate risks of revenue losses.

Authorities' Views

38. The authorities reaffirmed their commitment to improve Brazil's fiscal position. They viewed the zero-deficit target for 2024, with the tolerance margin of 0.25 percent of GDP, as achievable on the back of strong revenue performance. Automatic spending freezes could be activated if needed to compensate for higher-than-expected expenses on social security, while emergency related spending for *Rio Grande do Sul* would be outside the spending ceiling of the fiscal rule, in line with the declaration of calamity. The authorities noted the recent Supreme Court ruling that reinforced the Fiscal Responsibility Law principle requiring that tax breaks and structural increases in spending be offset by structural measures, including in initiatives proposed by Congress. They saw the revised primary balance path for 2025-28 as sufficient for achieving a stabilization of public debt by 2028. They acknowledged that following the successful implementation of revenue measures, which recovered the tax base lost after the 2022 tax cuts, efforts on the spending side could increase the flexibility of spending to facilitate fiscal adjustment. Spending reviews would contribute to opening fiscal space while a revenue-neutral direct tax reform to improve equity could be considered in the coming years. They saw the VAT reform as on track, with the upcoming passage of necessary bylaws, for effective implementation from 2026 onwards. The authorities noted that the reform includes a mechanism to adjust the reference rate during the transition period to compensate for any risks to revenue neutrality from informality and service sectors.

¹⁴ Sectoral heterogeneity in the indirect tax burden implies that, with a new reference rate of around 27.3 percent for all goods and services, some sectors would adjust their combined rates downwards while others would see their rate increase relative to the status quo.

¹⁵ The stock of accumulated (ICMS, PIS/COFINS) tax credits is still undisclosed. A study by GETAP (2020) shows that 41 large companies surveyed hold 0.3 percent of GDP tax credits.

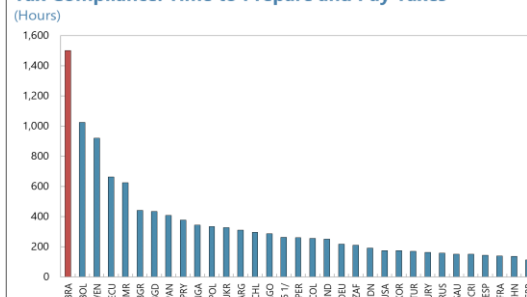
Box 4. VAT Reform: Revamping Indirect Taxation

Brazil's taxation of goods and services is highly complex. With five different taxes across three levels of government, rates can vary among the federal government, 26 states, and 5,568 municipalities, reflecting approximately 10 general tax rates and more than 300 differentiated rates and exemptions.

The complexity of the current system gives rise to widespread distortions. Compliance and litigation costs are among the largest worldwide, imposing a substantial burden on businesses. Cascading taxes due to overlapping bases and incomplete credits for intermediate inputs distort the allocation of factors of production in the economy. They also exacerbate differential treatment across sectors and firms, reflected, for instance, in a very high overall tax burden for the manufacturing sector compared with services and agriculture. Moreover, double taxation with overlaps in origin and destination principles for interstate transactions leads to geographic misallocations. Finally, opportunities for tax avoidance and evasion give rise to substantial legal uncertainty (also reflected in the large stocks of judicial claims), as well as significant compliance gaps translating into high statutory tax rates.

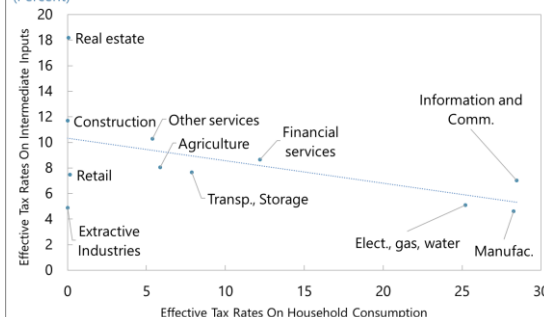
By gradually replacing the existing consumption taxes with a dual VAT by 2033, the reform would significantly reduce these distortions. The dual VAT will feature a federal component (CBS) and a subnational component (IBS), while a new excise (IS) would strictly focus on goods harmful to the environment and health. Implementation plans foresee phasing out federal taxes on goods and services by end-2027. Taxes of states and municipalities will gradually merge into the IBS from 2028 to 2033 with regional compensation funds staying in place for a transition period of 50 years. The tax regime for small enterprises (SIMPLES) will remain in place, but businesses can opt-in to VAT taxation benefiting from tax credits while maintaining their preferred rates, preparing for a gradual adjustment of SIMPLES terms and conditions over the longer horizon. One of the most important achievements of the reform is that both federal and subnational VAT components are applied on the same tax base anchored in the constitution since December 2023. After an initial freeze, states and municipalities would have some discretion in setting their IBS rate.

Tax Compliance: Time to Prepare and Pay Taxes



Source: World Bank World Development Indicators.
1/ Ex. Brazil.

Intermediate and Final Consumption Tax Burden by Sector



Source: IBGE, Input Output Table 2015.

Federal

COFINS – Contribuição Social para o Financiamento da Seguridade Social

PIS/PASEP – Programa de Integração Social

IPI – Imposto sobre Produtos Industrializados

States

ICMS – Imposto sobre Circulação de Mercadorias e Serviços

Municipalities

ISS – Imposto sobre Serviços

CBS (Contribuição sobre Bens e Serviços)

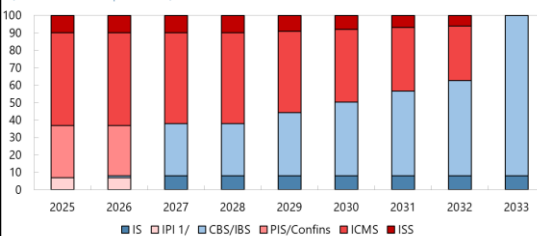
IS (Imposto Seletivo; for goods that are harmful to environment and health)

IBS (Imposto sobre Bens e Serviços)

Source: Complementary Bill of Law (PLP) 68/2024.

Transition to the Dual VAT

(Percent of consumption taxes)



Source: Treasury.

1/ The IPI will remain for 300 product codes to equalize for existing Manaus tax benefits.

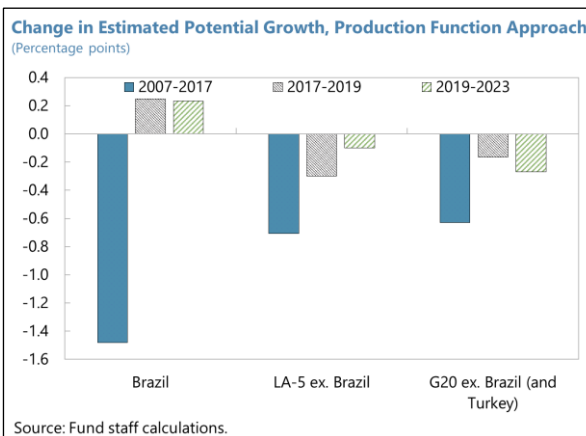
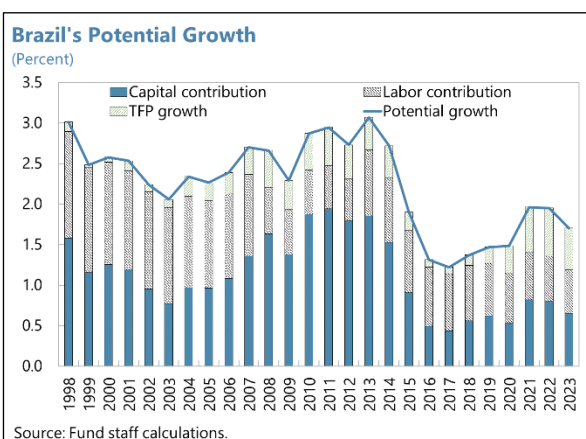
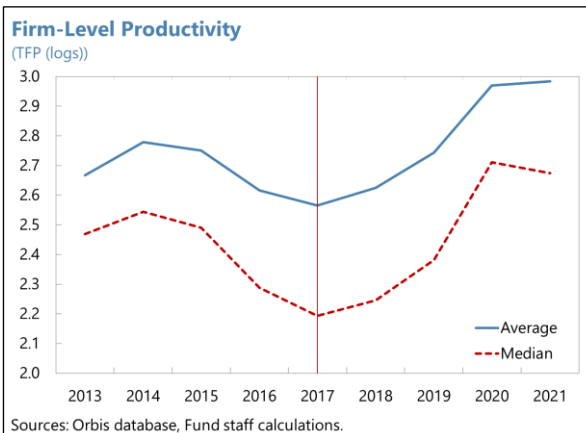
D. Fostering Stronger and More Inclusive Growth

Securing Stronger Growth

39. Brazil's potential growth is estimated to have increased in recent years. Staff estimates suggest that potential growth declined significantly during the 2014-2016 downturn.¹⁶ Since 2017, it has increased in the context of supply-side reforms, in contrast to the decline estimated for peer economies. The increase in Brazil's potential growth since 2017 is estimated to have been driven by rising TFP, reflecting catch-up toward the technological frontier and increasing trade integration, with contributions from capital and labor accumulation remaining broadly constant. Firm-level analysis provides further evidence of an increase in worker productivity since the 2017 major labor reform (Annex IX). Moreover, the decline since 2017 in labor litigation cases and costs associated with the reform is expected to continue supporting productivity through lower litigation costs, particularly for labor- and trade-intensive firms, and lower barriers for firm growth.

40. Potential growth is expected to rise further over the medium and long term, reflecting structural factors:

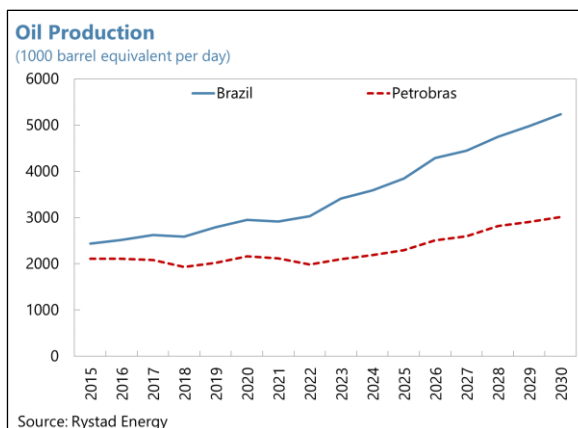
- **VAT Reform.** Assuming full implementation, the landmark reform could raise annual growth by 0.3-0.5 percentage points on average during the transition to the new steady state, depending on the role of informality (Annex VIII). The complete crediting of taxes currently paid on intermediate inputs is expected to boost investment by corporates, improve the economy's resource allocation, particularly in the manufacturing sector, and increase formal sector activities. Removing additional distortions, including from



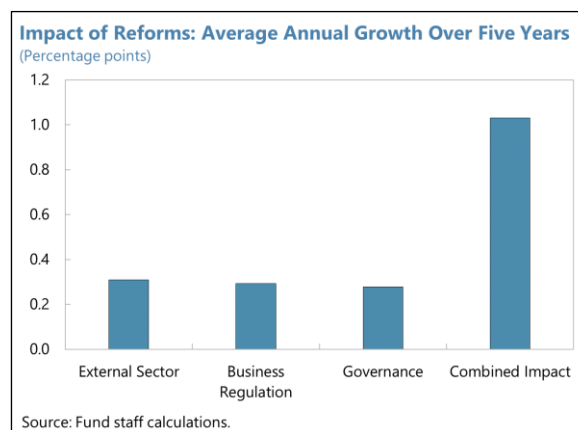
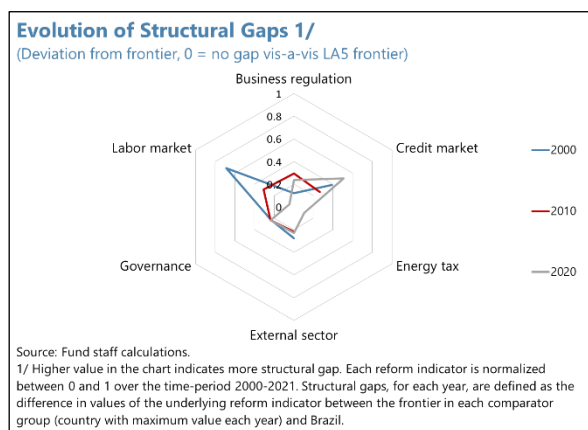
¹⁶ Potential growth estimates have been prepared by Sinem Celik (WHD). The estimation methodology builds on Celik and others (2023), "Potential Growth: A Global Database," World Bank Policy Research Working Paper 10354.

complexities in the tax code, very high litigation costs, and interstate double taxation, could further lift potential growth. However, legal uncertainty is likely to remain in the early phases of the reform, possibly offsetting some of the positive effects in the near term.

- Hydrocarbon Production.** Oil and gas output is expected to significantly increase in the coming years. Estimates by Rystad Energy are for a 56 percent rise in oil output between 2023 and 2031, making Brazil the world's fourth largest oil producer (after the United States, Saudi Arabia, and Russia). Staff estimates that this expansion could contribute 0.2 percentage points to annual GDP growth during 2024-2031. Oil output is projected to decline thereafter, although the extended forecast is inherently uncertain.



41. Continuing reforms to close structural gaps could yield significant additional gains compared to the baseline. Staff analysis suggests that closing gaps with LA5 peer economies in areas of major “first-generation” reforms related to the external sector, business regulation, and governance could increase annual growth in Brazil by about 0.3 percentage point per year for five years for each reform area, compared with the baseline projection. If implemented at the same time, this set of first-generation reforms could raise output in Brazil by an estimated 5 percent, implying an extra 1 percentage point in annual growth per year.¹⁷ Such an increase would support the authorities’ debt reduction objectives through higher fiscal revenues and lower sovereign borrowing costs.



- Advancing trade integration and simplifying business regulations would support a more competitive economy.** Brazil’s trade policy regime has relatively high tariff and non-tariff

¹⁷ The analysis, prepared by Andrea Medici and Marina Tavares (both RES), builds on Budina and others (2023), “Structural Reforms to Accelerate Growth, Ease Policy Trade-offs, and Support the Green Transition in Emerging Market and Developing Economies,” International Monetary Fund Staff Discussion Note SDN/2023/007.

barriers.¹⁸ Continuing progress with regional and intra-regional integration plans, including by reducing tariff and non-tariff barriers and pursuing deep commitments in trade facilitation and regulatory cooperation, could support greater participation in global value chains and increase productivity. Accompanying such integration with labor-market policies (such as job search assistance and training, income support, and social insurance programs) would improve labor mobility and mitigate adjustment costs. Simplifying regulations, reducing the administrative burden on start-ups, and easing entry barriers would further support competition and economic activity.

- **Further strengthening the anti-corruption framework as well as efficiency and independence of the judiciary would enhance the business environment.** Brazil has strengthened its anti-corruption framework, including for investigating and sanctioning foreign bribery, but challenges remain in implementing and enforcing the framework.¹⁹ The authorities have also strengthened environmental governance. Publication of asset declarations of high-level public officials, criminalization of illicit enrichment, and strengthening the conflict-of-interest system would support these efforts.
- **Addressing AML/CFT gaps identified by the FATF/GAFILAT assessment would mitigate related financial sector vulnerabilities.** Brazil has developed policies to tackle many of its higher money laundering (ML) risks and the BCB's supervision has strengthened detection and prevention of ML. Closing the remaining gaps would require strengthening the Financial Intelligence Unit (COAF) capacity and integrating the Federal Revenue Office into the AML/CFT regime, broadening the availability of beneficial ownership and financial information, and reconsidering the extent of court order requirements for access. Building on the existing robust understanding of ML threats from economic crimes, continuous analysis of the financial aspects of economic crimes, with a focus on cross-border illicit financial outflows and the use of ML investigations, would support the authorities' ongoing efforts to weaken organized criminal groups. Effective implementation of recently strengthened terrorist financing and targeted financial sanctions frameworks would reduce financial sector vulnerabilities.

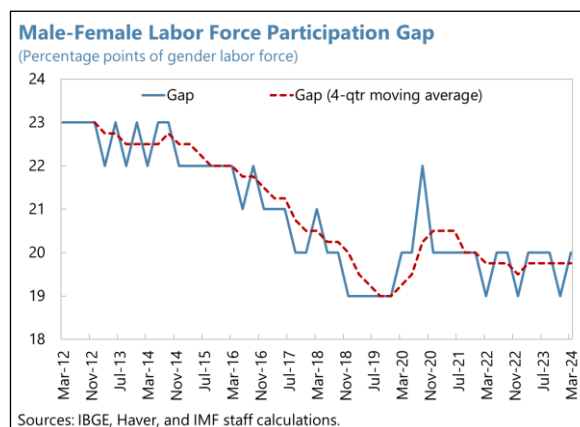
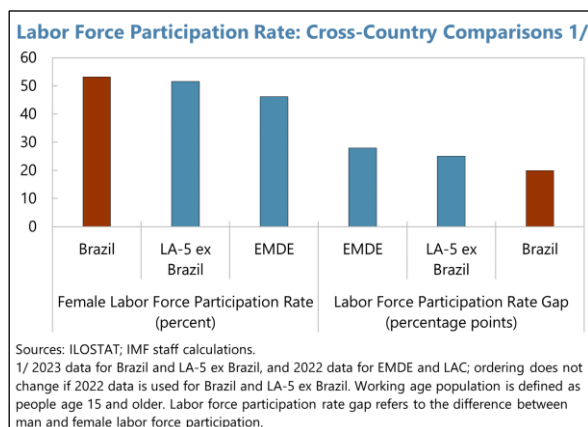
42. Intensifying ongoing efforts to boost labor force participation and facilitate skill upgrading would mitigate the expected drag from population aging on potential growth.

Brazil's working-age population is estimated to have peaked in 2021 at 70 percent of the total population and is expected to decline by more than 1 percentage point by 2030, which would reduce output growth through a lower employment contribution. Though Brazil fares better than regional and EMDE peers, the gap between male and female labor force participation has not returned to its pre-pandemic low. Progress in narrowing gender gaps in labor force participation and wages and addressing the misallocation of women's talents and abilities—including by

¹⁸ Brazil's simple average MFN tariff was 11.1 percent in 2022 according to the WTO Tariff Profiles, above the WTO average (around 9 percent). Non-tariff barriers include non-automatic import licensing and complex internal taxes. Trade defense measures are also often utilized, including recent anti-dumping investigations into imports of metals, chemicals, and tires, and announcements of a new tariff rate quota system for imports of steel from China.

¹⁹ [World Bank. 2024. Brazil – Country Partnership Framework for the Period FY24-28 \(English\).](#)

increasing daycare services and by implementing pay transparency measures—would further enhance economic potential. Addressing bottlenecks to the adoption of digital technologies would further support worker productivity, including by amplifying their ability to harness the benefits of AI. Enhancing skill levels, including through increases in public education attainment, building on programs such as *Pé-de-Meia*, is also warranted. Ensuring that adjustments to minimum wages are commensurate with productivity growth will minimize tradeoffs between inequality and job creation.



43. The authorities envisage increasing public investment, while preserving debt sustainability, as part of the Growth Acceleration Plan. More public investment is warranted to improve infrastructure including roads, rail, and waterways.²⁰ Federal capital expenditure amounted to 0.7 percent of GDP in 2023. At the same time, increasing investment would require creating space through tackling spending rigidities, as outlined in staff’s recommended scenario. Meanwhile, incorporating well-prioritized investment plans in a medium-term budget framework and improving coordination across levels of government will support public investment efficiency and sustainability. Continued timely and comprehensive fiscal reporting on public-private partnerships (PPPs), state-owned enterprises (SOEs), and public bank lending will support the monitoring of fiscal risks. The new industrial policy, *Nova Indústria Brasil*, could help to fill the infrastructure gap. It outlines a shift in sectoral focus to innovation and sustainability in agriculture; health; infrastructure; decarbonization and energy transition; digitalization; and defense. It is important to ensure that trade and investment measures are targeted to specific objectives where clearly identifiable externalities or market failures are well established and other policy options are unavailable; be consistent with World Trade Organization obligations; and avoid favoring domestic producers over imports, including for preventing retaliatory responses by trading partners and further fragmentation of global supply chains.

44. The global energy transition offers opportunities for Brazil to raise sustainable growth. Brazil has an exceptionally clean energy mix, with renewables accounting for 90 percent of total electricity production and projected to rise further.²¹ The recently approved energy transition

²⁰ [World Bank, 2023, “The Brazil of the Future: towards Productivity, Inclusion, and Sustainability”.](#)

²¹ [IMF, 2023, Brazil: Selected Issues, Country Report No. 2023/289.](#)

acceleration program (Paten) will further promote the development of renewable fuels, including aviation biokerosene, biodiesel, and low-carbon hydrogen, and incentivize sustainable energy production parks through favorable negotiations on tax debts.²² These initiatives could facilitate Brazil's transition to a low-carbon economy, encourage foreign investment in sustainable projects such as hydrogen, and increase medium-term growth.

Box 5. Financing the Ecological Transformation Plan

Despite impressive progress, climate financing gaps remain sizable. The World Economic Forum estimates Brazil's gap to finance the climate transition by 2030 at about R\$1 trillion (nearly 10 percent of GDP, [WEF 2023](#)). Moreover, climate investments, such as in renewable energy and climate-proof infrastructure, require long-term funding. To help fill in this gap, innovative structural instruments are being developed, including the Sustainable Taxonomy and new carbon market framework. Securing financing is particularly challenging for emerging markets that face higher borrowing costs than many advanced economies. Moreover, hedging FX exposure is expensive and underdeveloped for longer-term projects.

The government's new *Eco Invest* program aims to mobilize international climate financing. The program will offer four credit lines, which include: (i) a blended finance facility with longer-maturity credit; (ii) a long-term FX liquidity facility that provides contingent funding for projects with inflation-indexed revenues that face temporary cash flow shortfalls due to FX depreciation while servicing FX debt; (iii) an FX derivatives program that provides de-risking to local financing institutions that supply long-term FX hedging solutions to local investors; and (iv) financing for project structuring.

One goal of *Eco Invest* is to increase the supply of long-term FX hedging at more favorable conditions in cooperation with the Inter-America Development Bank (IDB). The FX derivatives line will focus on hedging operations between 10 and 25 years. Currently, liquidity in the FX derivative market for tenors beyond 10 years is relatively limited. The lack of liquidity at longer tenors in the FX derivatives market can pose barriers for attracting long-term investment in Brazil, as investors are unable to hedge their FX risks. The IDB will provide up to \$3.4 billion (0.2 percent of GDP) for the acquisition of FX derivatives, taking advantage of its AAA rating that will allow the IDB to sign derivative contracts with international banks at preferential terms. The presence of an AAA counterparty in the long-term FX market will likely increase the number of international banks willing to price these derivatives despite the limited market depth. The BCB will act as an intermediary and pass through preferential terms to local banks, which will have to post collateral to the BCB depending on the valuation of the derivatives. In addition, local banks will assume any credit risks related to the transactions with end investors.

Mandatory and voluntary carbon markets could further help address the financing gap, with necessary safeguards in place. The proposed cap-and-trade system for larger emitters would take about five years to become operational and its potential market value could reach, by some estimates, about R\$100 billion (nearly 1 percent of GDP) by 2030, generating around 0.3 percent of GDP of additional fiscal revenues annually. The more sectors (such as agriculture) and greenhouse gases are covered, the more cost-efficient the market and the larger the revenue potential will be. Complementing the mandatory market, voluntary carbon markets could generate additional market value. Securitizing or linking carbon credits to the above liquidity lines and other financing instruments is currently under consideration. Current flows are small but have the potential to grow significantly if accompanied by strong safeguards and robust rules and monitoring to ensure additionality and minimize reputational risks. The 2023 Forestry Law, for instance, allows companies with forestry concessions to generate carbon credits for forest preservation. Credits could be sold in Brazil's voluntary carbon market while mandatory participation of local communities in proceeds

²² The hydrogen regulatory framework is expected in the first half of 2024.

Box 5. Financing the Ecological Transformation Plan (concluded)

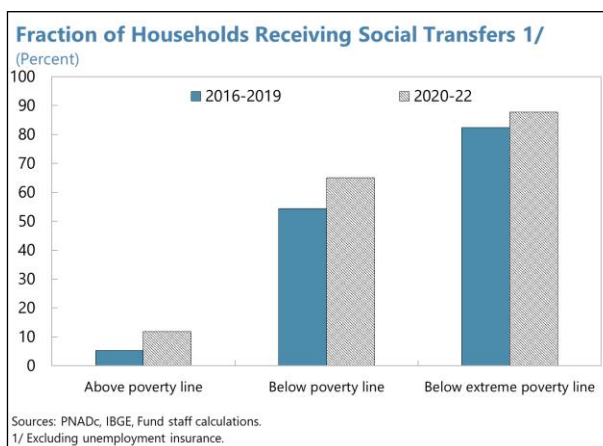
ensures communities' support and ownership. While offsetting carbon is not allowed by all major emission trading schemes, nor counted towards nationally determined contributions, domestically used credits, as in the case in Brazil, in particular if the focus is on emissions avoidance, could pave a way towards new, innovative forms of climate finance.

45. The authorities have made significant progress towards mobilizing financing for the Ecological Transformation Plan (Box 5). A second ESG bond issuance is scheduled for late 2024, with about 40 percent of funds earmarked for green projects. This step is complemented by a broad mixture of funding activities, such as an expansion of earmarked credit for low-carbon agriculture, and a redirection of tax-advantaged infrastructure bond issuance towards social and environmental infrastructure. The authorities are working closely with multilateral banks and international donors and secured a record financial contribution to the Amazon Fund in 2023. Private sector (and SOE) green bond issuances have been very active, with an important share of climate projects being privately financed, notably for renewable energy. The BCB's sustainability agenda has further advanced, including preparations for a green liquidity line, which would be launched upon finalizing the Sustainable Taxonomy.

Ensuring Growth Reaches All

46. Inequality in Brazil has been on a gradual declining path but continues to be high. The share of income of the bottom 10 percent of the population has improved from 0.8 percent of total income in 1995 to 1.2 percent in 2022, while that of the bottom 20 percent of the population has improved from 2.4 percent to 3.6 percent over the same timeframe (World Bank *World Development Indicators* database). Based on Gini index estimates from the Brazilian Institute of Geography and Statistics (IBGE), there has been a modest decline in inequality from an index level of 0.54 in 2012 to 0.52 in 2022. Within Brazil, there is variation with the highest inequality in the Northeast region and the lowest in the South region.

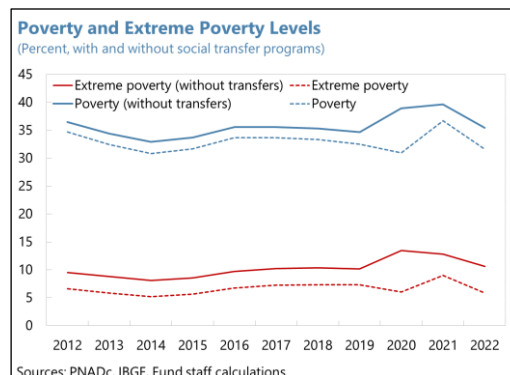
47. Social transfer programs have contributed to reducing poverty, while requiring substantial fiscal spending. Social transfer programs have on average been targeted toward more vulnerable households. The share of households below the poverty and extreme poverty line reporting receiving social transfers (excluding unemployment insurance) is significantly greater than the share of recipients above the poverty line. Social transfer programs have also played a significant role in reducing poverty rates (Box 6), in particular during the COVID-19 pandemic. At the same time, pandemic-related social protection spending amounted to 4.4 percent of GDP during the pandemic (above the average in advanced economies—2 percent of GDP, and emerging market economies—2.2 percent of



GDP).²³ General government social assistance spending reached 5.5 percent of GDP in 2020, up from 1.3 percent of GDP before the pandemic (2016-2019 average), and was 2.5 percent of GDP in 2023 (Table 7).

Box 6. Social Vulnerabilities and Social Protection

Social transfers have been associated with lower poverty in Brazil. Before the pandemic (2012-19), the poverty (extreme poverty) rate measured based on income *including* social transfers was about 33 (6) percent, compared with a higher poverty (extreme poverty) rate based on income percent *excluding* social transfers of 35 (9) percent. During the pandemic, the authorities expanded social transfer programs, with a further associated drop in poverty rates. For 2020, poverty and extreme poverty rates were reduced by, respectively, about a fifth and a half, after accounting for transfers.

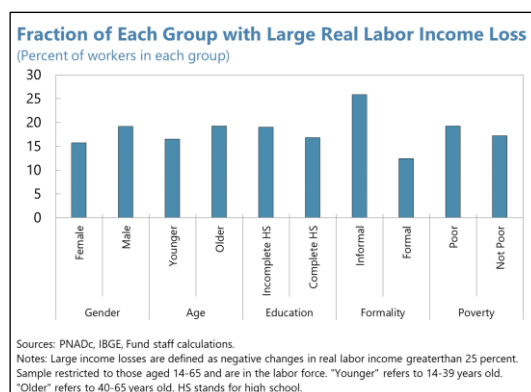
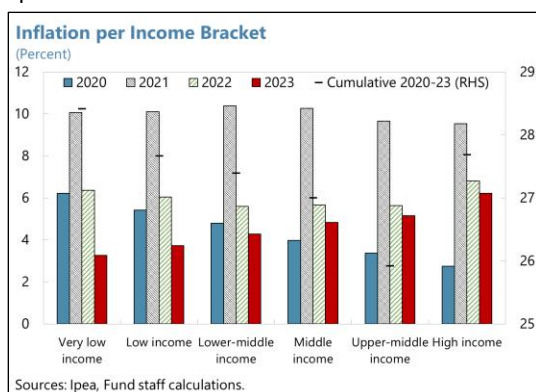


Informal workers and low-income households are among the most vulnerable to economic shocks.

Very low-income households were hit the hardest by rising energy and food prices during the global supply shocks of 2020. Although inflation facing the most vulnerable households in 2023 eased in both absolute and relative terms, cumulative inflation across 2020-2023 was the highest for the poorest households. Staff analysis based on household survey data suggests that the poor, the less educated, and informal workers are also more likely to experience more labor income volatility, with a higher fraction of workers in those groups experiencing large labor income losses compared to other demographic groups.^{1/} In addition, unemployment rates have been higher among female, younger, and less educated workers, implying differences in job prospects and labor market frictions among different demographic groups.

Young children face highest extreme poverty incidence among different age demographics in Brazil

(Figure 1). Children under 15 have historically been the most vulnerable group, with almost 10 percent living in extreme poverty, compared to the population average of about 6 percent. In contrast, supported by pension benefits, extreme poverty among people aged 60 or older is much lower, standing at about 2.3 percent in 2022.



^{1/} These results are comparable to those for Argentina, Chile, Mexico, and Peru, as documented in the [October 2023 Regional Economic Outlook, Western Hemisphere, Background Paper 1](#).

²³ See the estimates in "[Strengthening Income Stabilization through Social Protection in Emerging and Developing Economies: The Brazilian Experience](#)", IMF Working Paper No. 2023/052.

48. Increasing the effectiveness of social transfer programs and the progressivity of the tax system, building on ongoing initiatives, would help further reduce inequality and poverty, while supporting fiscal sustainability.²⁴ The authorities' continued monitoring of adherence to conditionality of social transfer programs and ensuring data quality of the single registry (*Cadastro Único*) remain essential for effective targeting. Steps to enhance efficiency and progressivity include increasing coordination across social protection programs and social transfers to avoid duplication of benefits in some households and deficiencies in others (such as child and youth benefits from *Bolsa Família*, *Salário Família*, and child-related income-tax deductions). Efforts to resume updating the *Cadastro Único* at regular intervals and address the backlog from the pandemic are welcome. Further improvements to cross-check data on enrollments and beneficiaries across programs could support the identification of overlaps and improve coverage. These initiatives could be complemented by reforms to make the PIT more efficient and progressive, including by eliminating regressive and inefficient tax expenditures.

Authorities' Views

49. Highlighting the considerable progress made over the last year, the authorities expect their reform agenda to foster even stronger sustainable growth and inclusion. They concurred with staff on the need for policies to boost female labor force participation and highlighted that the law on equal pay passed in 2023 would contribute to narrowing gender wage gaps. They emphasized their continued commitment to investing in education, with initiatives to strengthen educational attainment such as the *Pé-de-Meia* program. They highlighted steps taken to address inequality and increase the effectiveness of the social programs, including the introduction of benefits for young children under the *Bolsa Família* program and ongoing efforts to ensure the accuracy of the *Cadastro Único* household registry. They confirmed their commitment to ensuring that the new industrial policy (*Nova Indústria Brasil*) be in line with WTO obligations. Regarding the AML/CFT framework, they emphasized that the Financial Intelligence Unit has extensive powers to effectively investigate suspicious transactions. On climate finance, they emphasized progress made in launching innovative liquidity and FX hedging lines, as well as in the establishment of a sustainable taxonomy that would ensure a common ground for investors and policymakers. They concurred with the need for adequate safeguards for carbon markets to ensure additionality and mitigate reputational risks and affirmed that the framework would contain such provisions.

STAFF APPRAISAL

50. Growth is projected to moderate to 2.1 percent in 2024 before strengthening to 2.5 percent over the medium term. The moderation reflects a still restrictive monetary policy aimed at completing the convergence of inflation to target, a lower fiscal deficit, the flood calamity in *Rio Grande do Sul*, and a normalization of agricultural output from record levels. Inflation is expected to reach 3.7 percent by end-2024 and the 3 percent inflation target in the first half of 2026. Staff's assessment suggests that the external position in 2023 was broadly in line with the level

²⁴ For further details, see "[The Brazil of the Future: Towards Productivity, Inclusion, and Sustainability](#)", World Bank 2023.

implied by medium-term fundamentals and desirable policies. Staff's upward revision in its estimate of medium-term growth reflects supportive structural factors, such as the efficiency-enhancing VAT reform and an acceleration in hydrocarbon production.

51. The balance of risks to the growth outlook has improved but remains somewhat tilted to the downside, while uncertainty remains. Upside risks to growth include stronger-than-expected household consumption, a faster implementation of reforms, and investment in green growth opportunities. Downside risks stem from the flood calamity and uncertainty over fiscal measures, which could reduce policy credibility and result in higher borrowing costs. On the external front, downside risks include commodity price volatility, a slower-than-expected decline in global core inflation, as well as an abrupt slowdown in major trading partners. A sound financial system, adequate FX reserves, low reliance on FX debt, large government cash buffers, and a flexible exchange rate continue to support Brazil's resilience.

52. The careful pace of monetary easing has been appropriate and consistent with the inflation targeting framework. As disinflation proceeds, with inflation projected to remain within the target tolerance interval, maintaining flexibility on the pace and length of the easing cycle is prudent given resilient labor markets and expectations above target-levels. The BCB's policy stance and clear commitment to the 3 percent target bode well for the further decline in inflation expectations, conditional on continued credibility of both fiscal and monetary policy frameworks. The flexible exchange rate regime and adequate FX reserves remain valuable shock buffers. FX intervention could be used to address episodes of higher risk premia when FX liquidity becomes shallow without substituting for adjustment of macroeconomic policies when needed. The longstanding tax on certain financial transactions (IOF-FX) gives rise to an MCP under the Fund's new MCP policy, as well as to an exchange restriction. The authorities are not requesting an approval as the tax is being phased out and is expected to be eliminated in due course in line with the authorities' already announced plan to reduce the rate to zero, consistent with staff advice.

53. The financial system remains resilient, systemic risks are contained, and banks are highly liquid and adequately capitalized. Risks from non-bank financial institutions are contained, and the BCB is taking welcome steps to strengthen their oversight. Credit risks related to micro and small enterprises warrant close monitoring. The authorities have taken welcome steps to address households' debt burden and lower overall credit costs. Given the high cost of consumer loans, the authorities could consider applying a debt-service-to-income limit when necessary. Continued careful management of a bigger role for public banks is needed to mitigate any potential risks to the fiscal position, monetary policy transmission, and market efficiency.

54. The BCB remains at the forefront of financial innovation amid resource constraints. The financial innovation agenda has promoted financial inclusion, efficiency, and competition. The adoption of the instant payment system *Pix* continues to expand, making Brazil a global leader in transactions per capita. The BCB is also at the frontier of CBDCs with its flagship initiative *Drex*, while privacy and security challenges are being addressed. Building on past reforms on BCB autonomy, providing flexibility to cover operating expenses would allow the BCB to attract and retain the needed professional talent to continue contributing to and supervising technological innovations.

55. The authorities' commitment to continue improving the fiscal position is welcome. The draft 2025 LDO reaffirmed the 2024 federal primary zero-deficit target and proposed a zero-deficit

target for 2025, which is appropriate. The authorities envisage raising the primary balance further to a surplus of 1.0 percent of GDP by 2028. Based on more favorable macroeconomic assumptions than staff, notably on interest rates, the authorities estimate that public debt (authorities' definition) would stabilize by 2028, followed by a gradual decline thereafter. The authorities' intention to pursue a strategy entailing both expenditure and revenue measures is welcome.

56. Staff recommends a sustained and more ambitious fiscal effort that puts debt on a firmly downward path and opens space for priority investments. Staff's assessment of general government gross debt sustainability finds risks of debt distress to be moderate under the baseline scenario, but the debt trajectory remains highly sensitive to shocks and the materialization of contingent liabilities. The overwhelmingly domestic investor base, low external debt, and large cash buffers by the public sector mitigate risks and provide room for medium-term fiscal consolidation to proceed gradually. Staff recommends a path that achieves the zero federal primary deficit target in 2025, followed by a gradual improvement to a primary surplus of 2.5 percent of GDP by 2030, putting debt on a firmly downward trend and opening space for priority investments. Building on the fiscal rule, an enhanced fiscal framework with a strong medium-term fiscal anchor would reinforce credibility and sustainability. Eliminating inefficient tax expenditures and broadening the tax base by closing loopholes would support the adjustment. Reforming the PIT, including the taxation of dividends, could generate additional revenues and increase progressivity. Reforms to control spending pressures and tackle budget rigidities remain a priority.

57. The implementation of VAT reform is expected to boost productivity, create formal jobs, and improve the equity of the tax system. By removing inefficiencies, notably the incomplete crediting of taxes on intermediate inputs, staff estimates that the reform could lift output by 6-11 percent during the transition, assuming full implementation. The authorities' goal of revenue neutrality is welcome. If risks of revenue losses materialize, additional measures would be needed to secure fiscal sustainability.

58. Brazil's potential growth is estimated to have increased in recent years and continuing reforms to close structural gaps and foster inclusion could yield significant additional gains. Advancing trade integration and simplifying business regulations would support a more competitive economy. Industrial policies should remain narrowly targeted to specific objectives where externalities or market failures prevent effective market solutions, avoid increasing barriers to trade and investment, and not favor domestic producers over imports. Further strengthening the anti-corruption framework as well as the efficiency and independence of the judiciary would enhance the business environment. Addressing AML/CFT gaps identified by the FATF/GAFILAT assessment would address related financial sector vulnerabilities. Intensifying ongoing efforts to boost labor force participation and facilitate skill upgrading would mitigate the expected drag from population aging on potential growth. Increasing public investment to expand the economy's productive capacity is warranted, supported by efforts to create space by tackling spending rigidities. Further enhancing the effectiveness of social transfer programs and the progressivity of tax system would help advance the fight against poverty and inequality.

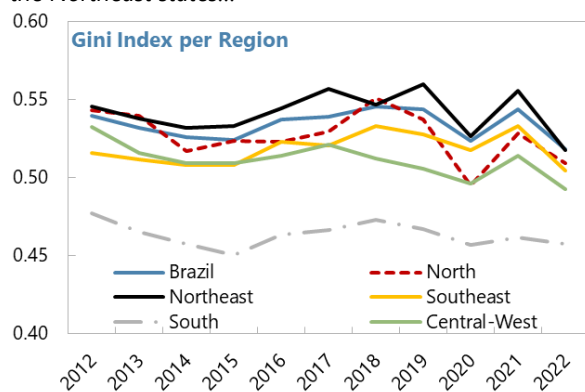
59. Implementation of the Ecological Transformation Plan is accelerating, with positive implications for sustainable growth. The authorities' commitment to halt illegal deforestation by 2030; progress on establishing Brazil's Sustainable Taxonomy; the new carbon market framework;

and the issuance of the first Global ESG sustainable government bond are commendable. Given sizable climate financing gaps, progress in designing instruments to attract longer-term green financing is welcome. These initiatives are expected to facilitate the transition to a low-carbon economy, encourage investment in sustainable projects, and boost economic output.

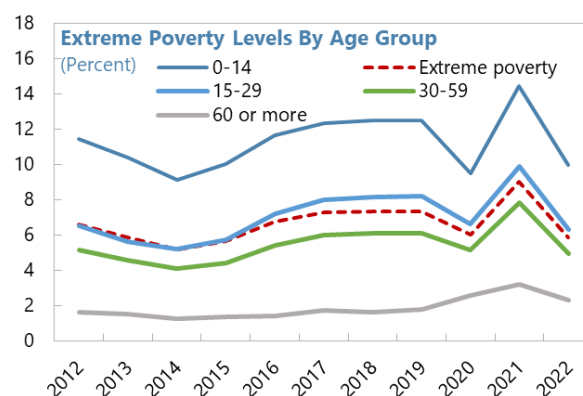
60. Staff recommends that the next Article IV consultation for Brazil be held on the standard 12-month cycle.

Figure 1. Brazil: Real Sector Developments

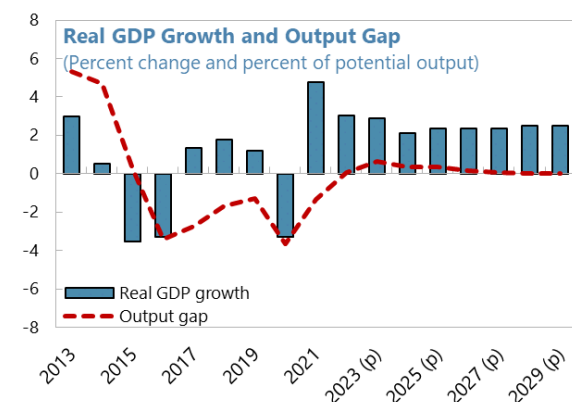
Though falling, inequality remains high, especially in the Northeast states...



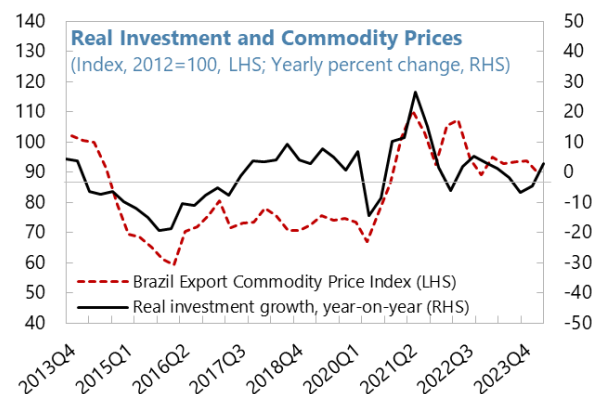
... with poverty rates higher among children.



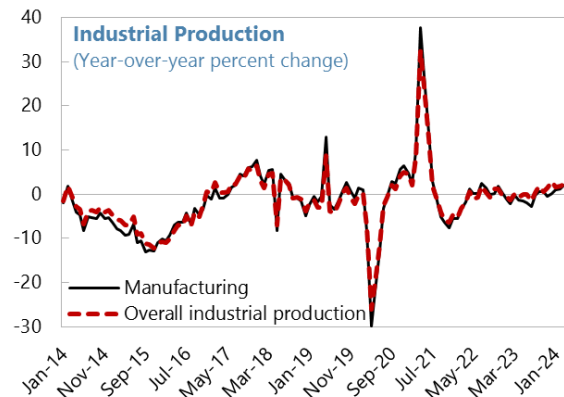
Growth is expected to moderate in 2024 before converging to 2.5 percent over the medium term.



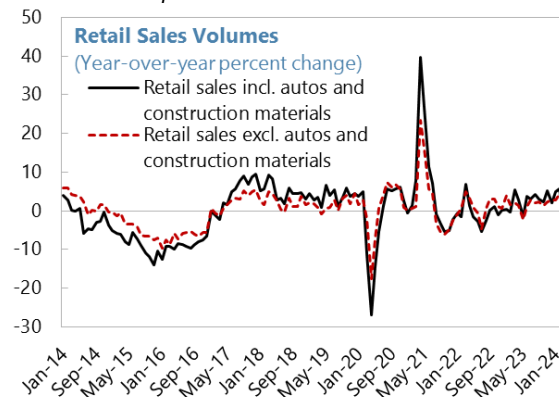
Following a sluggish 2023, real investment growth picked up in 2024Q1.



Growth in manufacturing has been positive and rising in recent months.



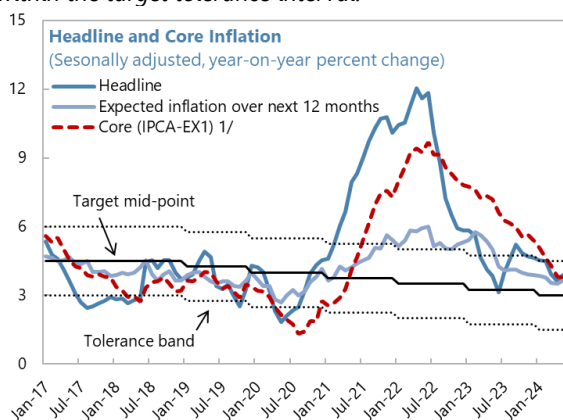
Broad and core retail sales of recent months suggest robust consumption.



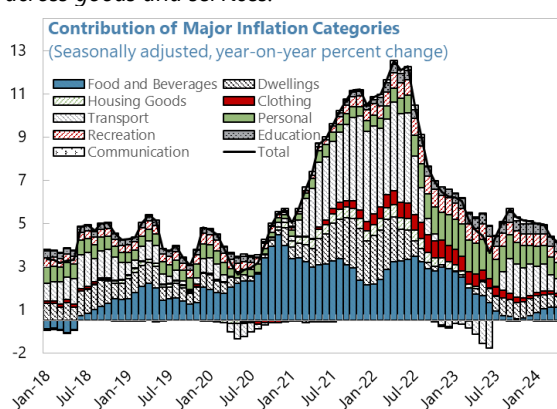
Sources: IBGE, CNI, Haver Analytics, and Fund staff calculations.

Figure 2. Brazil: Inflation Developments

Headline, core, and near-term inflation expectations are within the target tolerance interval.



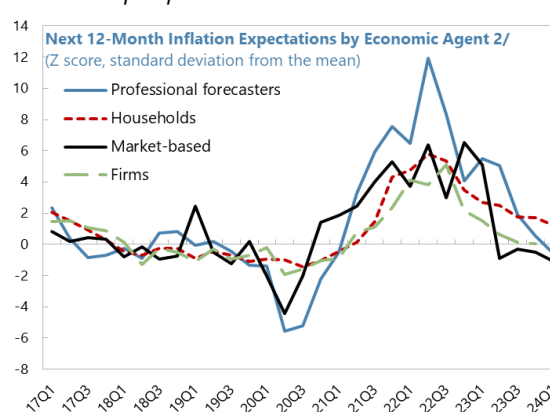
The easing of price pressures has been broad-based across goods and services.



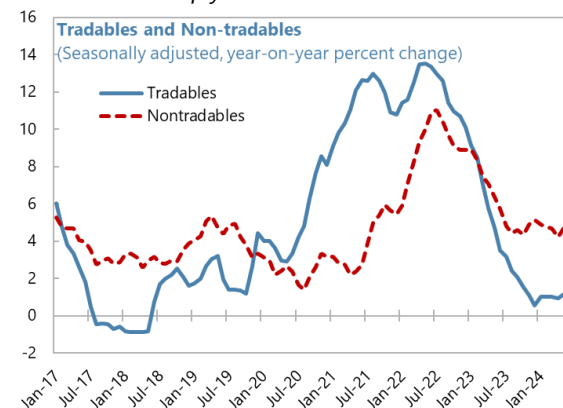
Real wages have recovered amid a tight labor market and are near their pre-pandemic path.



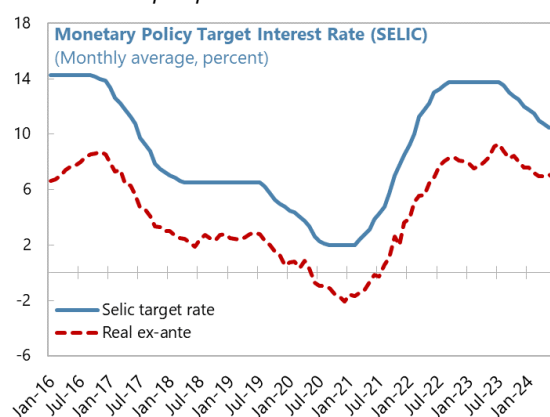
Inflation expectations across economic agents have declined to pre-pandemic levels.



Tradeable and, to a lesser extent, non-tradeable inflation has declined sharply.



Policy rates have declined, including in real terms, and remain above pre-pandemic levels.



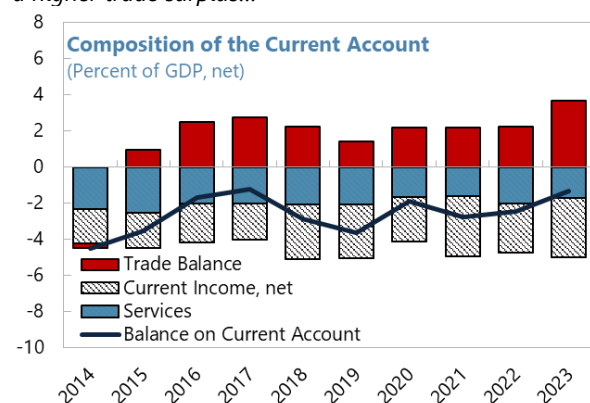
Sources: IBGE, CNI, Haver Analytics, and Fund staff calculations.

1/ IPCA-EX1 excludes domestic fuels, vehicle fuels, and 10 of 16 food and beverages items.

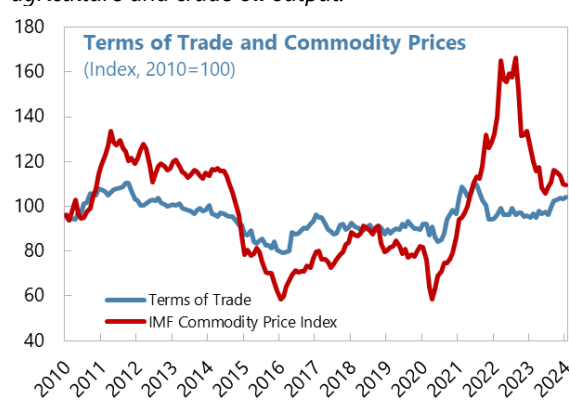
2/ Figure reports z-scores (deviations from mean divided by standard deviations) based on 2004Q1 to 2024Q1 at quarterly frequency. Firm-level inflation expectations not yet available for 2024Q1.

Figure 3. Brazil: External Sector Developments

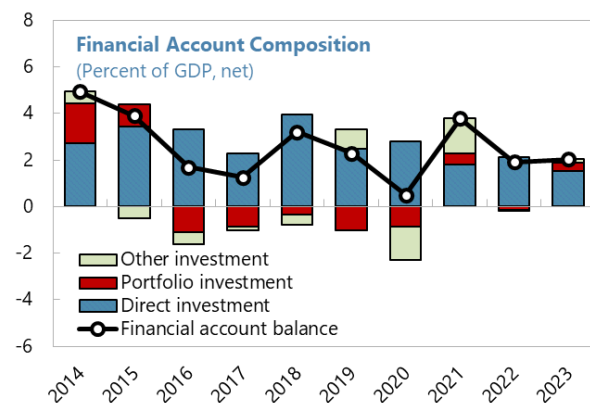
The current account deficit narrowed in 2023, driven by a higher trade surplus...



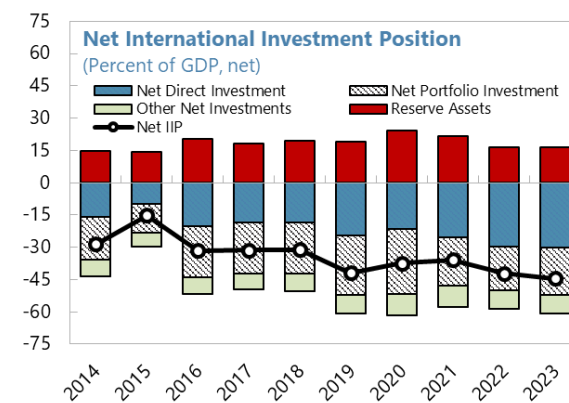
... benefitting from favorable terms of trade and record agriculture and crude oil output.



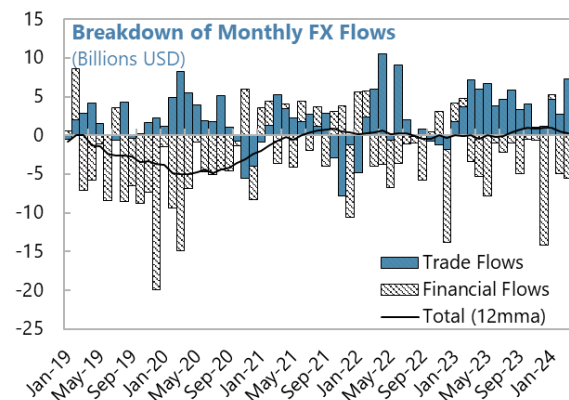
FDI inflows declined slightly in 2023 while portfolio investment registered positive inflows.



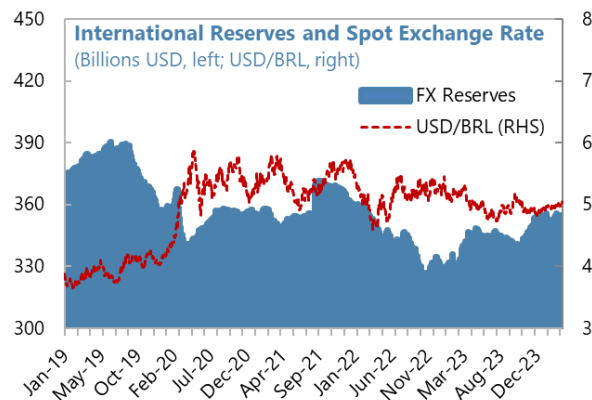
The NIIP continued to decline mostly due to negative valuation effects.



Financial flows have been volatile.



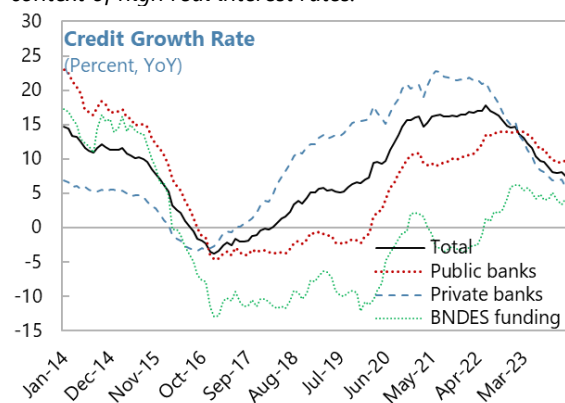
The exchange rate appreciated in 2023 and FX reserves increased.



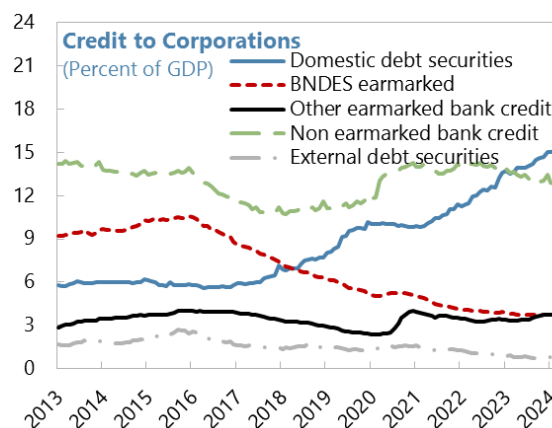
Sources: BCB, Haver Analytics, Bloomberg, and Fund staff calculations.

Figure 4. Brazil: Financial Sector Developments

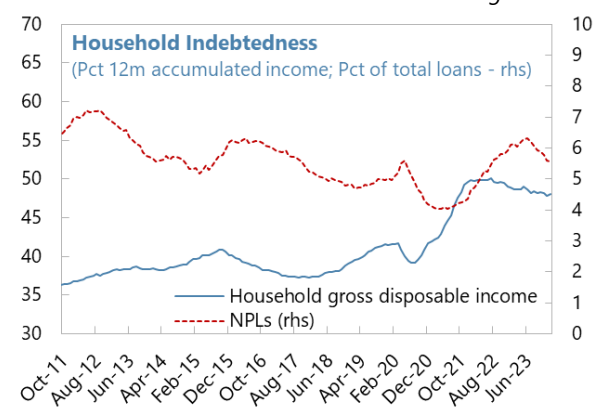
Credit to the private sector slowed in 2023 in the context of high real interest rates.



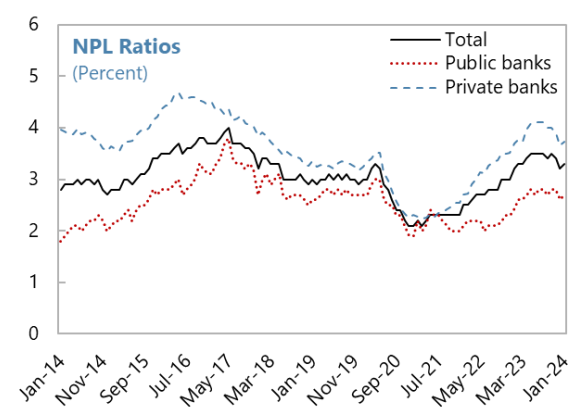
Corporates are increasingly relying on debt securities.



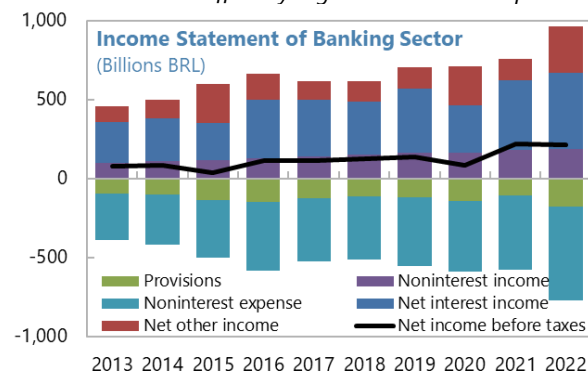
The household-debt-to-income ratio is trending down.



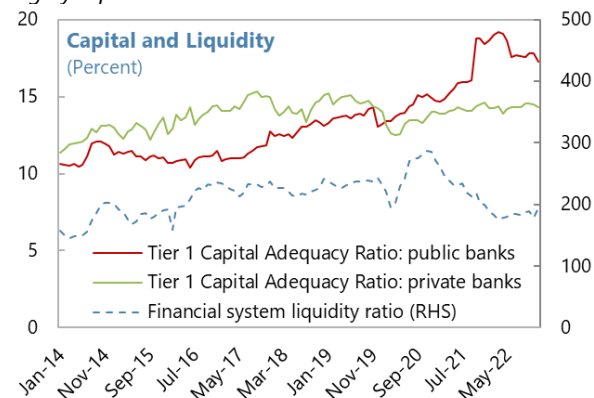
NPL ratios started to decline in mid-2023.



Banking sector profitability has been stable, with additional income offset by higher noninterest expense.



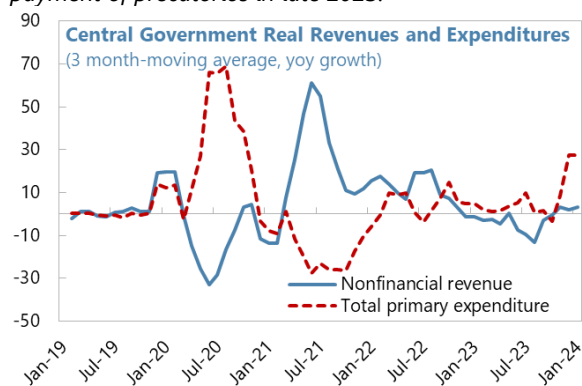
The financial system has adequate capital and remains highly liquid.



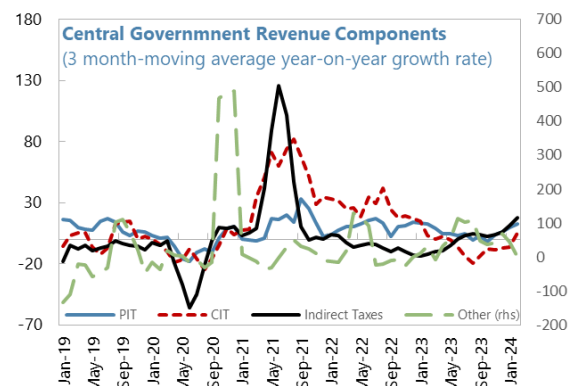
Sources: IBGE, CNI, Haver Analytics, CEIC, and Fund staff calculations.

Figure 5. Brazil: Fiscal Sector Developments

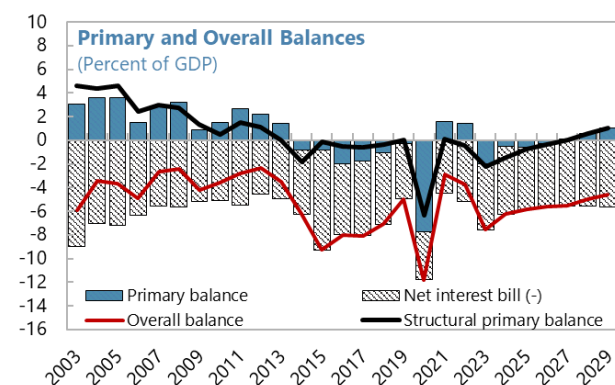
Revenue growth picked since mid-2023, while the strong increase in primary expenditure is explained by the payment of precatórios in late 2023.



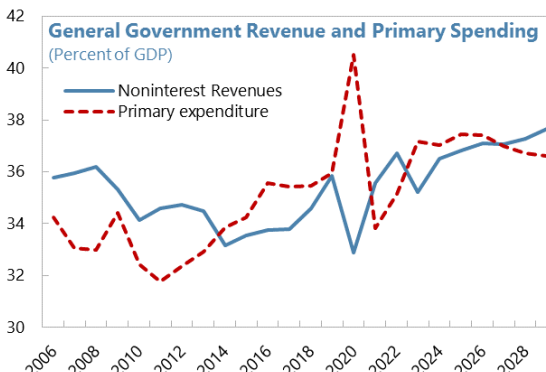
New tax measures and the phasing out of pandemic-related tax cuts helped arrest the decline in revenue.



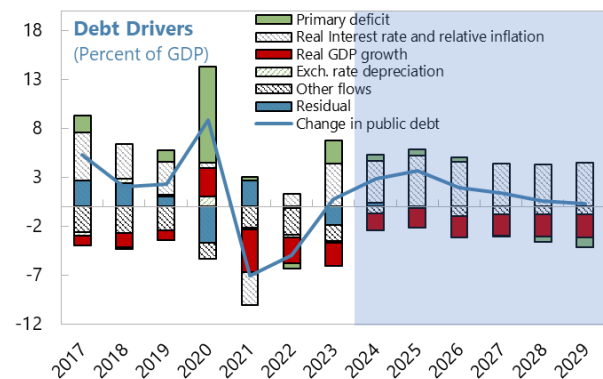
Fiscal balances fell in 2023 but are expected to rise gradually over the medium term.



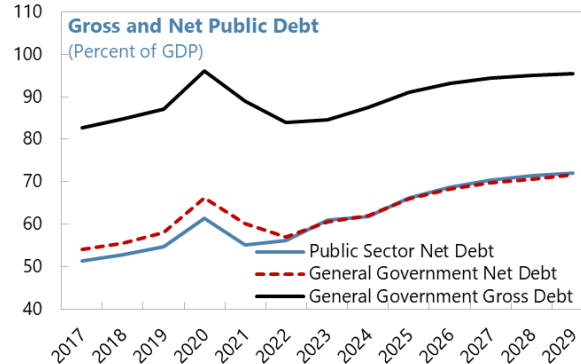
The general government expenditure-to-GDP ratio is expected to decline gradually over the medium term in line with the fiscal rule with the revenue ratio above its 2023 level.



Unfavorable interest rate-growth differentials are expected to add to debt in coming years.



Gross and net debt ratios are expected to increase over the medium term and stabilize in 2032.



Sources: Treasury, BCB, Haver Analytics, and Fund staff calculations.

Table 1. Brazil: Selected Economic Indicators 2022-29

| | | I. Social and Demographic Indicators | | | | | | | |
|---|-------|--|-------|-------------------|-------|-------|-------|-------|-------|
| Area (thousands of sq. km.) | 8,510 | Health | | | | | | | |
| Agricultural land (percent of land area) | 30.2 | Physicians per 1000 people (2023) | | 2.6 | | | | | |
| | | Hospital beds per 1000 people (2023) 1/ | | 2.4 | | | | | |
| Population (2023) | | Access to safe water (2022) | | 88.0 | | | | | |
| Total (millions) | 216.3 | Education (2023) | | | | | | | |
| Annual rate of growth (percent) | 0.7 | Adult illiteracy rate | | 5.4 | | | | | |
| Density (per sq. km.) | 25.4 | Net enrollment rates, percent in: | | | | | | | |
| Unemployment rate (Q1, 2024) | 7.9 | Primary education | | 99.4 | | | | | |
| | | Secondary education | | 92.2 | | | | | |
| Population characteristics (2022) | | Poverty rate (in percent, 2022) 2/ | | 31.6 | | | | | |
| Life expectancy at birth (years) | 75.5 | | | | | | | | |
| Infant mortality (per thousand live births) | 12.6 | | | | | | | | |
| Income distribution (2022) | | GDP, local currency (2023) | | R\$10,856 billion | | | | | |
| Palma ratio 3/ | 3.6 | GDP, dollars (2023) | | US\$2,174 billion | | | | | |
| Gini coefficient (post taxes and transfers) | 51.8 | GDP per capita (2023) | | US\$10,050 | | | | | |
| Main export products: airplanes, metallurgical products, soybeans, automobiles, electronic products, iron ore, coffee, and oil. | | | | | | | | | |
| II. Economic Indicators | | | | | | | | | |
| | | Proj. | | | | | | | |
| | | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| National accounts and prices | | (Annual percentage change) | | | | | | | |
| GDP at current prices | | 11.8 | 7.7 | 7.2 | 6.0 | 5.9 | 6.0 | 6.1 | 6.1 |
| GDP at constant prices | | 3.0 | 2.9 | 2.1 | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 |
| Consumption | | 3.7 | 2.8 | 2.0 | 2.2 | 2.1 | 2.1 | 2.3 | 2.3 |
| Investment (GFCF) | | 1.1 | -3.0 | 0.8 | 0.9 | 1.3 | 1.4 | 1.6 | 1.7 |
| Consumer prices (IPCA, average) | | 9.3 | 4.6 | 4.0 | 3.2 | 3.1 | 3.0 | 3.0 | 3.0 |
| Consumer prices (IPCA, end of period) | | 5.8 | 4.6 | 3.7 | 3.2 | 3.0 | 3.0 | 3.0 | 3.0 |
| GDP deflator | | 8.5 | 4.7 | 5.0 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 |
| Gross domestic investment | | (Percent of GDP) | | | | | | | |
| Private sector | | 14.3 | 12.4 | 12.2 | 11.9 | 11.7 | 11.6 | 11.5 | 11.4 |
| Public sector | | 3.7 | 3.7 | 3.7 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| Gross national saving | | | | | | | | | |
| Private sector | | 19.2 | 21.9 | 20.5 | 20.3 | 19.3 | 18.8 | 18.3 | 17.8 |
| Public sector | | -3.6 | -7.2 | -6.4 | -6.3 | -5.5 | -5.1 | -4.6 | -4.2 |
| Public sector finances | | | | | | | | | |
| Central government primary balance (national representation, incl. BCB) 4/ | | 0.5 | -2.4 | -0.6 | -0.7 | -0.4 | 0.1 | 0.6 | 1.0 |
| General government NLB primary balance | | 1.3 | -2.0 | -0.7 | -0.8 | -0.4 | 0.1 | 0.6 | 1.0 |
| General government NLB structural primary balance (in percent of potential GDP) | | -0.7 | -2.2 | -1.5 | -1.0 | -0.5 | 0.1 | 0.6 | 1.0 |
| General government NLB | | -4.0 | -7.6 | -6.8 | -6.8 | -5.9 | -5.5 | -5.1 | -4.7 |
| Net public sector debt | | 56.1 | 60.9 | 61.4 | 65.9 | 68.3 | 70.0 | 71.1 | 71.8 |
| General government gross debt, Authorities' definition | | 71.7 | 74.4 | 77.1 | 80.5 | 82.1 | 83.4 | 84.0 | 84.3 |
| General government gross debt | | 83.9 | 84.7 | 87.5 | 91.2 | 93.1 | 94.5 | 95.1 | 95.4 |
| Of which: Foreign currency linked | | 4.0 | 3.6 | 3.6 | 3.7 | 3.7 | 3.8 | 3.8 | 3.8 |
| Money and credit | | (Annual percentage change) | | | | | | | |
| Base money 5/ | | 16.6 | 20.4 | 7.2 | 6.0 | 5.9 | 6.0 | 6.1 | 6.1 |
| Broad money 6/ | | 10.6 | 15.5 | 7.3 | 5.9 | 6.0 | 6.0 | 6.1 | 6.1 |
| Bank loans to the private sector | | 14.6 | 6.9 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 |
| Balance of payments | | (Billions of U.S. dollars, unless otherwise specified) | | | | | | | |
| Trade balance | | 44.2 | 80.6 | 78.2 | 80.4 | 83.4 | 90.0 | 95.4 | 100.9 |
| Exports | | 340.3 | 344.4 | 345.6 | 350.4 | 357.1 | 369.3 | 380.1 | 391.7 |
| Imports | | 296.2 | 263.8 | 267.4 | 270.0 | 273.8 | 279.3 | 284.7 | 290.8 |
| Current account | | -48.3 | -30.8 | -40.0 | -40.8 | -42.9 | -44.7 | -45.5 | -47.4 |
| Capital account and financial account | | 47.0 | 29.7 | 40.0 | 40.8 | 42.9 | 44.7 | 45.5 | 47.4 |
| Foreign direct investment (net inflows) | | 41.3 | 36.0 | 37.2 | 38.7 | 40.3 | 41.8 | 43.4 | 45.1 |
| Terms of trade (percentage change) | | -7.1 | 2.4 | -3.4 | -2.0 | -2.0 | -1.0 | -0.7 | -0.8 |
| Merchandise exports (in US\$, annual percentage change) | | 19.8 | 1.2 | 0.3 | 1.4 | 1.9 | 3.4 | 2.9 | 3.0 |
| Merchandise imports (in US\$, annual percentage change) | | 19.6 | -10.9 | 1.4 | 0.9 | 1.4 | 2.0 | 1.9 | 2.1 |
| Total external debt (in percent of GDP) | | 34.9 | 33.7 | 32.6 | 32.3 | 31.0 | 29.7 | 28.6 | 27.5 |
| Memorandum items: | | (Percent, unless otherwise specified) | | | | | | | |
| Output Gap | | 0.1 | 0.6 | 0.4 | 0.3 | 0.2 | 0.1 | 0.0 | 0.0 |
| Current account (in percent of GDP) | | -2.5 | -1.4 | -1.8 | -1.7 | -1.7 | -1.7 | -1.6 | -1.6 |
| Unemployment rate 7/ | | 9.3 | 8.0 | 7.6 | 7.4 | 7.4 | 7.4 | 7.5 | 7.5 |
| Gross official reserves (in US\$ billions) | | 325 | 355 | 355 | 355 | 355 | 355 | 355 | 355 |
| REER (annual average in percent; appreciation +) | | 12.1 | 4.6 | ... | ... | ... | ... | ... | ... |

Sources: Central Bank of Brazil, Ministry of Finance, IBGE, IPEA, and Fund staff estimates.

1/ Includes inpatient beds and complementary beds.

2/ Computed by IBGE using World Bank's threshold for upper-middle income countries (US\$5.5/day).

3/ Share of income of the top 10% divided by share of income of the bottom 40%.

4/ Includes federal government, Central Bank, and the social security system (INSS). The 2023 primary balance excludes pandemic-related funds from PIS/PASEP, as per BCB definition.

5/ Currency issued, required deposits held at the Central Bank plus other Central Bank liabilities to other depository corporations.

6/ Currency outside depository corporations, transferable deposits, other deposits and securities other than shares.

7/ Unemployment rate for 2022 and 2023 shows the average of March, June, September, and December.

Table 2. Brazil: Balance of Payments, 2022-29
(In billions of US dollars, unless otherwise indicated)

| | 2022 | 2023 | Proj. | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| Current Account | -48.3 | -30.8 | -40.0 | -40.8 | -42.9 | -44.7 | -45.5 | -47.4 |
| Trade balance | 44.2 | 80.6 | 78.2 | 80.4 | 83.4 | 90.0 | 95.4 | 100.9 |
| Exports (fob) | 340.3 | 344.4 | 345.6 | 350.4 | 357.1 | 369.3 | 380.1 | 391.7 |
| Imports (fob) | 296.2 | 263.8 | 267.4 | 270.0 | 273.8 | 279.3 | 284.7 | 290.8 |
| Income, net | -52.8 | -73.8 | -78.0 | -79.6 | -83.0 | -90.1 | -94.6 | -100.2 |
| Capital and Financial Account | 47.0 | 29.7 | 40.0 | 40.8 | 42.9 | 44.7 | 45.5 | 47.4 |
| Capital account | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Financial account 1/ | 46.8 | 29.3 | 39.7 | 40.4 | 42.5 | 44.4 | 45.2 | 47.1 |
| Direct investment, net | 41.3 | 36.0 | 37.2 | 38.7 | 40.3 | 41.8 | 43.4 | 45.1 |
| Assets | 33.4 | 28.3 | 29.3 | 30.4 | 31.6 | 32.8 | 34.1 | 35.4 |
| Liabilities | 74.6 | 64.2 | 66.5 | 69.1 | 71.9 | 74.6 | 77.5 | 80.4 |
| Portfolio investment, net | -2.9 | 7.3 | -3.4 | -3.3 | -4.2 | -4.9 | -5.1 | -5.0 |
| Financial Derivatives, net | 2.0 | 8.0 | 0.8 | 1.3 | 2.7 | 3.1 | 3.3 | 2.3 |
| Other investment, net | -0.9 | -0.6 | 5.0 | 3.7 | 3.8 | 4.4 | 3.6 | 4.8 |
| Change in Reserve Assets, net | 7.3 | -21.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Errors and Omissions | 1.2 | 1.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Memorandum Items: | | | | | | | | |
| Gross reserves (eop) 1/ | | | | | | | | |
| In billions of U.S. dollars | 324.7 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 |
| Current account (in percent of GDP) | -2.5 | -1.4 | -1.8 | -1.7 | -1.7 | -1.7 | -1.6 | -1.6 |
| Trade balance (in percent of GDP) | 2.3 | 3.7 | 3.4 | 3.4 | 3.3 | 3.3 | 3.4 | 3.4 |
| Merchandise exports (in percent of GDP) | 17.4 | 15.8 | 15.2 | 14.8 | 14.2 | 13.7 | 13.4 | 13.0 |
| Merchandise imports (in percent of GDP) | 15.2 | 12.1 | 11.8 | 11.4 | 10.9 | 10.4 | 10.0 | 9.7 |
| Export volume (yoy change, in percent) | 6.1 | 9.5 | 2.6 | 3.5 | 4.0 | 4.3 | 3.2 | 3.2 |
| Import volume (yoy change, in percent) | 0.4 | 1.0 | 0.6 | 1.3 | 1.8 | 2.3 | 1.9 | 1.9 |
| Export price index (yoy change, in percent) | 13.7 | -6.5 | -1.8 | -1.7 | -1.6 | -0.5 | 0.1 | 0.2 |
| Import price index (yoy change, in percent) | 22.4 | -8.8 | 1.6 | 0.4 | 0.4 | 0.5 | 0.8 | 1.1 |
| Terms of trade (yoy change, in percent) | -7.1 | 2.4 | -3.4 | -2.0 | -2.0 | -1.0 | -0.7 | -0.8 |
| Oil price (Brent blend; US\$ per barrel) | 96.4 | 80.6 | 81.3 | 76.4 | 72.9 | 70.4 | 68.6 | 67.4 |
| REER (annual average in percent; appreciation +) | 12.1 | 4.6 | ... | ... | ... | ... | ... | ... |
| GDP in billions of U.S. dollars | 1,952 | 2,174 | 2,272 | 2,365 | 2,520 | 2,689 | 2,840 | 3,005 |

Sources: Central Bank of Brazil; and Fund staff estimates and projections.

1/ Historical numbers include valuation changes.

Table 3. Brazil: Main Fiscal Aggregates, Federal Government National Representation, 2022-29
(In percent of GDP, unless otherwise indicated)

| | 2022 | 2023 | Proj. | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| Nonfinancial revenue | 23.0 | 21.7 | 23.0 | 22.9 | 23.1 | 23.3 | 23.6 | 23.8 |
| Revenue administered by SRF | 13.8 | 13.3 | 14.5 | 14.3 | 14.3 | 14.2 | 14.0 | 14.0 |
| PIT | 2.9 | 3.0 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.1 |
| CIT | 5.3 | 4.7 | 5.2 | 5.1 | 5.1 | 5.1 | 5.1 | 5.0 |
| Indirect taxes | 4.7 | 4.6 | 5.0 | 5.1 | 5.1 | 5.0 | 4.9 | 4.9 |
| Trade taxes | 0.6 | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Other | 0.3 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Social security contributions | 5.3 | 5.5 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 |
| Other revenue | 3.8 | 2.9 | 2.9 | 2.9 | 3.0 | 3.1 | 3.1 | 3.2 |
| <i>Of which: royalties and dividends from resource extraction</i> | 1.9 | 1.3 | 1.3 | 1.4 | 1.5 | 1.6 | 1.7 | 1.8 |
| Unallocated measures | 0.0 | 0.0 | 0.0 | 0.1 | 0.2 | 0.5 | 0.8 | 1.0 |
| Total primary expenditure | 22.5 | 23.8 | 23.6 | 23.6 | 23.6 | 23.2 | 23.0 | 22.8 |
| Current expenditures | 22.0 | 23.0 | 22.9 | 22.9 | 22.9 | 22.6 | 22.3 | 22.2 |
| Personnel | 3.4 | 3.4 | 3.2 | 3.2 | 3.2 | 3.1 | 3.0 | 3.0 |
| Pension benefits | 7.9 | 8.3 | 8.1 | 8.1 | 8.1 | 8.1 | 8.1 | 8.1 |
| Transfer to subnational governments | 4.5 | 4.2 | 4.5 | 4.5 | 4.5 | 4.5 | 4.4 | 4.4 |
| Other | 6.2 | 7.2 | 7.1 | 7.0 | 7.0 | 6.8 | 6.7 | 6.6 |
| Capital expenditures | 0.4 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 |
| Fund surpluses and statistical discrepancy | 0.1 | -0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Primary balance | 0.5 | -2.4 | -0.6 | -0.7 | -0.4 | 0.1 | 0.6 | 1.0 |
| Overall balance | -4.5 | -8.1 | -6.3 | -6.1 | -5.4 | -4.8 | -4.4 | -4.0 |
| Memorandum items | | | | | | | | |
| Federal net interest expenditure | 5.0 | 5.7 | 5.7 | 5.4 | 5.0 | 4.9 | 5.0 | 5.0 |
| Public sector net debt 1/ | 56.1 | 60.9 | 61.4 | 65.9 | 68.3 | 70.0 | 71.1 | 71.8 |
| General government gross debt, Authorities' definition | 71.7 | 74.4 | 77.1 | 80.5 | 82.1 | 83.4 | 84.0 | 84.3 |
| General government gross debt 2/ | 83.9 | 84.7 | 87.5 | 91.2 | 93.1 | 94.5 | 95.1 | 95.4 |
| Nominal GDP (billions of reais) | 10,080 | 10,856 | 11,637 | 12,337 | 13,066 | 13,845 | 14,688 | 15,577 |

Sources: Central Bank of Brazil; Ministry of Finance; Ministry of Planning; and Fund staff estimates and projections.

1/ Includes assets, which mainly comprise international reserves, outstanding liabilities of public financial institutions to the Treasury, financial assets of public enterprises, and assets of the federal labor fund (FAT).

2/ Unlike the authorities' definition, gross general government debt comprises treasury bills at the central bank's balance sheet not used under repurchase agreements.

Table 4. Brazil: Depository Corporations and Monetary Aggregates, 2019-23
(End of period, in billions of reais)

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|----------------|-----------------|-----------------|----------------|-----------------|
| I. Central Bank | | | | | |
| Net foreign assets | 1,421.6 | 1,823.9 | 1,911.6 | 1,597.2 | 1,629.4 |
| Net international reserves | 1,408.0 | 1,790.2 | 1,901.9 | 1,579.5 | 1,691.3 |
| Other foreign assets (net) | 13.6 | 33.8 | 9.7 | 17.7 | -61.9 |
| Net domestic assets | -682.0 | -1,025.0 | -1,091.4 | -640.3 | -477.0 |
| Net claims on public sector | 424.9 | 470.5 | 218.2 | 361.3 | 810.6 |
| Net credit to other depository corporations | -902.1 | -1,127.5 | -924.8 | -876.7 | -1,149.6 |
| Other items (net) | 204.8 | 368.0 | 384.8 | 124.9 | 138.0 |
| Base money | 739.6 | 798.9 | 820.3 | 956.8 | 1,152.3 |
| Currency issued | 280.7 | 370.4 | 339.0 | 342.3 | 341.6 |
| Liabilities to other depository corporations | 449.5 | 418.4 | 475.5 | 605.9 | 747.6 |
| Reserve deposits | 35.9 | 61.1 | 70.2 | 77.3 | 81.1 |
| Liabilities to other sectors | 9.4 | 10.1 | 5.8 | 8.6 | 63.1 |
| II. Depository Corporations 1/ | | | | | |
| Net foreign assets | 1,070.7 | 1,297.3 | 1,334.0 | 1,087.6 | 1,089.3 |
| Net international reserves | 1,408.0 | 1,790.2 | 1,901.9 | 1,579.5 | 1,691.3 |
| Other foreign assets (net) | -337.3 | -492.8 | -567.9 | -491.9 | -602.0 |
| Net domestic assets | 5,584.2 | 6,598.1 | 7,250.2 | 8,403.3 | 9,869.5 |
| Net claims on public sector | 3,544.4 | 4,288.4 | 4,192.6 | 4,608.5 | 5,559.9 |
| Credit to other financial corporations | 294.2 | 377.8 | 492.9 | 582.8 | 623.3 |
| Credit to private sector | 4,639.7 | 5,227.5 | 6,200.8 | 7,116.9 | 7,778.0 |
| Of which: loans to private sector | 3,224.0 | 3,753.4 | 4,414.7 | 5,057.2 | 5,408.2 |
| Other items (net) | 3,086.6 | 3,514.9 | 3,834.1 | 4,103.2 | 4,319.3 |
| Capital | 1,209.5 | 1,492.0 | 1,625.0 | 1,475.4 | 1,701.6 |
| Other liabilities excluded from broad money | 1,877.1 | 2,022.9 | 2,209.1 | 2,627.8 | 2,617.7 |
| Broad money (M2) 2/ | 6,654.9 | 7,895.4 | 8,584.2 | 9,490.9 | 10,958.8 |
| Currency in circulation | 228.3 | 308.9 | 286.0 | 293.2 | 288.8 |
| Demand deposits | 216.6 | 328.6 | 363.9 | 349.3 | 434.7 |
| Quasi-money liabilities | 6,209.9 | 7,257.9 | 7,934.4 | 8,848.4 | 10,235.3 |
| (Percent of GDP) | | | | | |
| Base money | 10.0 | 10.5 | 9.1 | 9.5 | 10.6 |
| Broad money (M2) | 90.1 | 103.8 | 95.3 | 94.2 | 100.9 |
| Financial sector credit to the private sector | 62.8 | 68.7 | 68.8 | 70.6 | 71.6 |
| Of which: bank loans to private sector | 43.6 | 49.3 | 49.0 | 50.2 | 49.8 |
| III. Other Financial Corporations | | | | | |
| Net foreign assets | 21.1 | 37.0 | 48.8 | 37.8 | 47.6 |
| Net domestic assets | 2,064.5 | 2,193.7 | 2,226.8 | 2,418.7 | 2,606.2 |
| Net claims on public sector | 304.5 | 325.7 | 347.3 | 372.9 | 395.8 |
| Credit to private sector | 1,564.9 | 1,723.3 | 1,689.9 | 1,768.8 | 2,036.4 |
| Of which: loans to private sector | 125.5 | 142.1 | 154.8 | 174.0 | 180.5 |
| Claims on depository corporations | 714.2 | 774.6 | 805.7 | 803.7 | 827.7 |
| Other items (net) | -530.7 | -642.9 | -623.6 | -538.8 | -673.1 |
| Memorandum item: | | | | | |
| GDP (in billions of reais) | 7,389 | 7,610 | 9,012 | 10,080 | 10,856 |

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Includes the Central Bank of Brazil, commercial banks, multiple banks, financial (money market) investment funds, Banco do Brasil, Federal Savings Bank, state savings bank, investment banks, National Bank for Economic and Social Development (BNDES), state development banks, finance and investment companies, housing credit companies, and mortgage companies.

2/ M2 includes the liabilities to other financial corporations, state and municipal governments, nonfinancial public enterprises, other nonfinancial corporations, and other resident sectors.

Table 5. Brazil: Medium-Term Macroeconomic Framework, 2022-29

| | | | Proj. | | | | | |
|--|--|-------|-------|-------|-------|-------|-------|-------|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| MACROECONOMIC FRAMEWORK | | | | | | | | |
| | (Percent of GDP, unless otherwise specified) | | | | | | | |
| GDP growth at constant prices (percent) | 3.0 | 2.9 | 2.1 | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 |
| Consumer prices (IPCA, end of period, percent) | 5.8 | 4.6 | 3.7 | 3.2 | 3.0 | 3.0 | 3.0 | 3.0 |
| Gross domestic investment | 18.1 | 16.1 | 15.9 | 15.7 | 15.5 | 15.4 | 15.2 | 15.1 |
| Private sector | 14.3 | 12.4 | 12.2 | 11.9 | 11.7 | 11.6 | 11.5 | 11.4 |
| Public sector | 3.7 | 3.7 | 3.7 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| Gross domestic saving | 15.6 | 14.7 | 14.1 | 13.9 | 13.8 | 13.7 | 13.6 | 13.6 |
| Private sector | 19.2 | 21.9 | 20.5 | 20.3 | 19.3 | 18.8 | 18.3 | 17.8 |
| Public sector | -3.6 | -7.2 | -6.4 | -6.3 | -5.5 | -5.1 | -4.6 | -4.2 |
| External current account balance | -2.5 | -1.4 | -1.8 | -1.7 | -1.7 | -1.7 | -1.6 | -1.6 |
| Central government primary balance | 0.5 | -2.4 | -0.6 | -0.7 | -0.4 | 0.1 | 0.6 | 1.0 |
| Consolidated non-financial public sector | | | | | | | | |
| Primary balance | 0.5 | -2.4 | -0.6 | -0.7 | -0.4 | 0.1 | 0.6 | 1.0 |
| Overall balance | -4.0 | -7.6 | -6.8 | -6.8 | -5.9 | -5.5 | -5.1 | -4.7 |
| Public sector net debt 1/ | 56.1 | 60.9 | 61.4 | 65.9 | 68.3 | 70.0 | 71.1 | 71.8 |
| General government gross debt, Authorities' definition | 71.7 | 74.4 | 77.1 | 80.5 | 82.1 | 83.4 | 84.0 | 84.3 |
| General government gross debt 2/ | 83.9 | 84.7 | 87.5 | 91.2 | 93.1 | 94.5 | 95.1 | 95.4 |
| EXTERNAL DEBT 3/ 4/ | | | | | | | | |
| | (Billions of U.S. dollars) | | | | | | | |
| Total external debt | 681.1 | 732.6 | 741.2 | 762.7 | 781.7 | 798.6 | 812.6 | 825.6 |
| Medium- and long-term | 613.3 | 652.2 | 661.5 | 680.6 | 697.5 | 712.7 | 725.2 | 736.7 |
| Nonfinancial public sector | 197.3 | 222.4 | 216.8 | 223.0 | 228.6 | 233.5 | 237.6 | 241.4 |
| Public sector banks | 38.9 | 41.0 | 42.4 | 43.6 | 44.7 | 45.7 | 46.5 | 47.2 |
| Private sector | 444.8 | 469.3 | 482.6 | 498.3 | 513.7 | 528.9 | 543.8 | 558.7 |
| Short-term | 67.8 | 80.5 | 79.8 | 82.1 | 84.1 | 85.9 | 87.4 | 88.8 |
| Medium- and long-term external debt service | 88.9 | 112.3 | 124.7 | 132.9 | 137.7 | 142.0 | 145.8 | 149.3 |
| Amortization | 70.3 | 84.7 | 94.4 | 101.0 | 104.7 | 108.0 | 111.0 | 113.8 |
| Interest | 18.6 | 27.6 | 30.3 | 31.9 | 33.0 | 33.9 | 34.8 | 35.5 |
| | (Percent of GDP) | | | | | | | |
| Total external debt | 34.9 | 33.7 | 32.6 | 32.3 | 31.0 | 29.7 | 28.6 | 27.5 |
| Medium- and long-term | 31.4 | 30.0 | 29.1 | 28.8 | 27.7 | 26.5 | 25.5 | 24.5 |
| Nonfinancial public sector | 10.1 | 10.2 | 9.5 | 9.4 | 9.1 | 8.7 | 8.4 | 8.0 |
| Public sector banks | 2.0 | 1.9 | 1.9 | 1.8 | 1.8 | 1.7 | 1.6 | 1.6 |
| Private sector | 22.8 | 21.6 | 21.2 | 21.1 | 20.4 | 19.7 | 19.1 | 18.6 |
| Short-term | 3.5 | 3.7 | 3.5 | 3.5 | 3.3 | 3.2 | 3.1 | 3.0 |
| | (Percent of gross international reserves) | | | | | | | |
| Medium- and long-term external debt service | 27.4 | 31.6 | 35.1 | 37.4 | 38.8 | 40.0 | 41.1 | 42.1 |
| Amortization | 21.6 | 23.9 | 26.6 | 28.4 | 29.5 | 30.4 | 31.3 | 32.0 |
| Interest | 5.7 | 7.8 | 8.5 | 9.0 | 9.3 | 9.6 | 9.8 | 10.0 |
| Short-term debt | 20.9 | 22.7 | 22.5 | 23.1 | 23.7 | 24.2 | 24.6 | 25.0 |
| MEMORANDUM ITEMS: | | | | | | | | |
| Gross reserves (eop) 4/ | | | | | | | | |
| In billions of U.S. dollars | 324.7 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 |
| In percent of external short-term debt (maturity basis) | 479.1 | 441.1 | 445.1 | 432.6 | 422.1 | 413.1 | 406.0 | 399.6 |
| In months of prospective GNFS imports | 11.2 | 12.0 | 11.8 | 11.8 | 11.6 | 11.3 | 11.0 | 10.6 |
| In percent of external short-term debt (residual maturity) | 212.9 | 206.9 | 196.4 | 190.1 | 184.8 | 180.3 | 176.5 | 173.4 |
| Short-term debt in percent of total external debt | 10.0 | 11.0 | 10.8 | 10.8 | 10.8 | 10.8 | 10.8 | 10.8 |
| Intercompany debt (in billions of U.S. dollars) | 256.8 | 269.0 | 278.5 | 288.3 | 298.5 | 309.0 | 320.0 | 331.4 |
| In percent of GDP | 13.2 | 12.4 | 12.3 | 12.2 | 11.8 | 11.5 | 11.3 | 11.0 |
| GDP (billion US\$) | 1,952 | 2,174 | 2,272 | 2,365 | 2,520 | 2,689 | 2,840 | 3,005 |

Sources: Central Bank of Brazil; and Fund staff estimates and projections.

1/ Includes assets, which mainly comprise international reserves, outstanding liabilities of public financial institutions to the Treasury, financial assets of public enterprises, and assets of the federal labor fund (FAT).

2/ Unlike the authorities' definition, gross general government debt comprises treasury bills at the central bank's balance sheet not used under repurchase agreements.

3/ Includes intercompany debt.

4/ Historical numbers include valuation changes.

Table 6. Brazil: External Vulnerability, 2022-29
(In billions of U.S. dollars, unless otherwise indicated)

| | 2022 | 2023 | Proj. | | | | | |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| | | | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| Trade | | | | | | | | |
| Exports of GNFS (12-month percent change, US\$) | 20.6 | 2.4 | 0.7 | 1.8 | 2.3 | 3.8 | 3.3 | 3.5 |
| Imports of GNFS (12-month percent change, US\$) | 22.9 | -7.8 | 2.2 | 1.7 | 2.2 | 2.8 | 2.7 | 3.0 |
| Terms of trade (12-month percent change) | -7.1 | 2.4 | -3.4 | -2.0 | -2.0 | -1.0 | -0.7 | -0.8 |
| Current account | | | | | | | | |
| Current account | -48.3 | -30.8 | -40.0 | -40.8 | -42.9 | -44.7 | -45.5 | -47.4 |
| In percent of GDP | -2.5 | -1.4 | -1.8 | -1.7 | -1.7 | -1.7 | -1.6 | -1.6 |
| Capital and financial account | | | | | | | | |
| Capital Account | 47.0 | 29.7 | 40.0 | 40.8 | 42.9 | 44.7 | 45.5 | 47.4 |
| Financial Account | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Portfolio investment (net) | 46.8 | 29.3 | 39.7 | 40.4 | 42.5 | 44.4 | 45.2 | 47.1 |
| Foreign direct investment (net) | -2.9 | 7.3 | -3.4 | -3.3 | -4.2 | -4.9 | -5.1 | -5.0 |
| Of which: intercompany loans (net) | 41.3 | 36.0 | 37.2 | 38.7 | 40.3 | 41.8 | 43.4 | 45.1 |
| | 16.3 | 9.1 | 9.4 | 9.8 | 10.2 | 10.6 | 11.0 | 11.4 |
| Short-term external liabilities of commercial banks | 44.7 | 55.1 | 56.9 | 60.0 | 61.3 | 40.6 | 39.7 | 39.1 |
| External debt | | | | | | | | |
| Total external debt 1/ | 681.1 | 732.6 | 741.2 | 762.7 | 781.7 | 798.6 | 812.6 | 825.6 |
| In percent of gross reserves | 209.8 | 206.4 | 208.8 | 214.8 | 220.2 | 224.9 | 228.9 | 232.5 |
| Amortization of external MLT debt (in percent of GNFS exports) | 20.7 | 24.6 | 27.3 | 28.8 | 29.3 | 29.2 | 29.2 | 29.0 |
| External interest payments (in percent of GNFS exports) | 5.5 | 8.0 | 8.8 | 9.1 | 9.2 | 9.2 | 9.2 | 9.1 |
| Reserves | | | | | | | | |
| Gross reserves | 324.7 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 | 355.0 |
| In months of prospective GNFS imports | 11.2 | 12.0 | 11.8 | 11.8 | 11.6 | 11.3 | 11.0 | 10.6 |
| In percent of broad money (M2) | 17.8 | 15.7 | 15.7 | 14.7 | 13.9 | 13.1 | 12.4 | 11.7 |
| In percent of short-term external debt (maturity basis) | 212.9 | 206.9 | 196.4 | 190.1 | 184.8 | 180.3 | 176.5 | ... |
| Exchange rate | | | | | | | | |
| REER (annual average in percent; appreciation +) | 12.1 | 4.6 | ... | ... | ... | ... | ... | ... |

Sources: Central Bank of Brazil; Bloomberg; and Fund staff estimates.

1/ Includes intercompany loans.

Table 7. Brazil: General Government GFSM 2014, 2022-29

(In percent of GDP, unless otherwise indicated)

| | 2022 | 2023 | Proj. | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| Revenue | 39.5 | 37.8 | 38.9 | 38.8 | 39.0 | 39.0 | 39.1 | 39.3 |
| Taxes | 24.7 | 23.9 | 25.2 | 25.1 | 25.1 | 25.0 | 24.9 | 24.9 |
| Income, profits and capital gains | 9.0 | 8.7 | 9.3 | 9.1 | 9.1 | 9.1 | 9.1 | 9.1 |
| Payroll and workforce | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Property taxes | 1.6 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Goods and services | 13.2 | 12.7 | 13.2 | 13.3 | 13.3 | 13.3 | 13.2 | 13.2 |
| International trade and transactions | 0.6 | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Social contributions | 7.5 | 7.4 | 7.6 | 7.6 | 7.6 | 7.6 | 7.6 | 7.6 |
| Social security contributions (RGPS) | 5.1 | 5.3 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Other social contributions (RPPS) | 2.3 | 2.2 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| Other revenue | 7.3 | 6.5 | 6.2 | 6.0 | 6.1 | 5.9 | 5.8 | 5.9 |
| Interest | 2.8 | 2.6 | 2.1 | 2.1 | 2.0 | 1.8 | 1.7 | 1.7 |
| Other | 4.5 | 3.9 | 4.1 | 3.9 | 4.1 | 4.1 | 4.1 | 4.2 |
| Total expenditure | 43.4 | 45.4 | 45.7 | 45.6 | 44.9 | 44.5 | 44.2 | 44.0 |
| Expenses | 43.0 | 45.0 | 45.3 | 45.1 | 44.5 | 44.0 | 43.7 | 43.5 |
| Compensation of employees | 10.6 | 10.8 | 11.7 | 11.6 | 11.6 | 11.5 | 11.4 | 11.4 |
| Use of goods and services | 5.4 | 5.5 | 5.5 | 5.5 | 5.5 | 5.4 | 5.4 | 5.4 |
| Consumption of fixed capital | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Interest | 8.0 | 8.2 | 8.2 | 8.1 | 7.5 | 7.4 | 7.4 | 7.4 |
| Subsidies and grants | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Social benefits | 15.2 | 16.5 | 15.9 | 16.0 | 15.9 | 15.8 | 15.7 | 15.6 |
| Social security | 8.6 | 9.4 | 8.9 | 9.0 | 9.0 | 9.0 | 8.9 | 8.9 |
| Social assistance | 2.1 | 2.5 | 2.6 | 2.6 | 2.6 | 2.5 | 2.4 | 2.5 |
| Other social benefits (RPPS) | 4.5 | 4.6 | 4.5 | 4.4 | 4.4 | 4.3 | 4.3 | 4.2 |
| Other | 2.0 | 2.2 | 2.2 | 2.1 | 2.1 | 2.1 | 2.0 | 2.0 |
| Net investment in non-financial assets | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Net lending and borrowing | -4.0 | -7.6 | -6.8 | -6.8 | -5.9 | -5.5 | -5.1 | -4.7 |
| Methodological and statistical discrepancy | 1.4 | 1.2 | | | | | | |
| Overall balance (national representation, includes BCB) | -5.4 | -8.8 | | | | | | |
| Net lending and borrowing primary | 1.3 | -2.0 | -0.7 | -0.8 | -0.4 | 0.1 | 0.6 | 1.0 |
| Methodological and statistical discrepancy | 0.1 | 0.2 | | | | | | |
| Primary balance (national representation, includes BCB) | 1.2 | -2.3 | | | | | | |

Sources: Treasury; and Fund staff estimates and projections.

Table 8. Brazil: States GFSM 2014, 2022-29
(In percent of GDP, unless otherwise indicated)

| | 2022 | 2023 | Proj. | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| Revenue | 13.4 | 12.5 | 12.5 | 12.4 | 12.5 | 12.4 | 12.4 | 12.4 |
| Taxes | 8.0 | 7.6 | 7.7 | 7.6 | 7.6 | 7.7 | 7.7 | 7.7 |
| Property taxes | 0.8 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Goods and services | 7.2 | 6.8 | 6.8 | 6.7 | 6.8 | 6.8 | 6.8 | 6.8 |
| Social contributions | 1.1 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Grants and transfers | 3.2 | 2.9 | 3.0 | 2.9 | 3.0 | 3.0 | 2.9 | 2.9 |
| Other revenue | 1.0 | 1.0 | 0.8 | 0.8 | 0.9 | 0.8 | 0.8 | 0.8 |
| Total expenditure | 13.6 | 13.4 | 13.5 | 13.4 | 13.3 | 13.2 | 13.2 | 13.2 |
| Expenses | 13.2 | 13.2 | 13.3 | 13.2 | 13.1 | 13.1 | 13.0 | 13.0 |
| Compensation of employees | 4.3 | 4.3 | 4.3 | 4.2 | 4.2 | 4.2 | 4.2 | 4.2 |
| Wages | 3.4 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 | 3.4 | 3.4 |
| Social contributions | 0.9 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Use of goods and services | 1.8 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.8 |
| Consumption of fixed capital | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Interest | 0.9 | 1.1 | 1.0 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 |
| Grants | 2.6 | 2.4 | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 |
| Social benefits | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.3 | 2.3 | 2.3 |
| Social assistance | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Other social benefits (RPPS) | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| Other | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Non-financial assets transactions | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Net lending and borrowing | -0.2 | -0.9 | -1.0 | -1.0 | -0.8 | -0.8 | -0.8 | -0.8 |
| Methodological and statistical discrepancy (net interest) | 0.1 | -0.3 | | | | | | |
| Overall balance (national representation) | -0.3 | -0.6 | | | | | | |
| Net lending and borrowing primary | 0.5 | 0.0 | -0.1 | -0.1 | 0.0 | 0.1 | 0.0 | 0.0 |
| Methodological and statistical discrepancy | 0.1 | -0.3 | | | | | | |
| Primary balance (national representation) | 0.4 | 0.3 | | | | | | |

Sources: Treasury; and Fund staff estimates and projections.

Table 9. Brazil: Municipalities GFSM 2014, 2022-29 1/
(In percent of GDP, unless otherwise indicated)

| | 2022 | 2023 | Proj. | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| Revenue | 10.2 | 10.3 | 10.5 | 10.4 | 10.5 | 10.5 | 10.4 | 10.4 |
| Taxes | 2.0 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| Property taxes | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Goods and services | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| Social contributions | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Grants and transfers | 7.2 | 6.9 | 7.6 | 7.5 | 7.5 | 7.5 | 7.5 | 7.5 |
| Other revenue | 0.5 | 0.8 | 0.3 | 0.3 | 0.4 | 0.3 | 0.3 | 0.3 |
| Total expenditure | 9.6 | 10.1 | 10.5 | 10.4 | 10.5 | 10.5 | 10.4 | 10.4 |
| Expenses | 9.4 | 9.7 | 10.1 | 10.0 | 10.1 | 10.0 | 10.0 | 10.0 |
| Compensation of employees | 4.2 | 4.3 | 4.3 | 4.3 | 4.3 | 4.3 | 4.3 | 4.3 |
| Wages | 3.5 | 3.7 | 3.7 | 3.6 | 3.6 | 3.6 | 3.6 | 3.6 |
| Social contributions | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Use of goods and services | 2.9 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Consumption of fixed capital | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Interest | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Social benefits (RPPS) | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Other | 0.7 | 0.8 | 1.1 | 1.1 | 1.2 | 1.1 | 1.1 | 1.1 |
| Non-financial assets transactions | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| Net lending and borrowing | 0.5 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Methodological and statistical discrepancy (net interest) | 0.3 | 0.4 | | | | | | |
| Overall balance (national representation) | 0.2 | -0.1 | | | | | | |
| Net lending and borrowing primary | 0.3 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Methodological and statistical discrepancy | 0.0 | 0.0 | | | | | | |
| Primary balance (national representation) | 0.3 | -0.1 | | | | | | |

Sources: Treasury; and Fund staff estimates and projections.

1/ Historical GFSM 2014 municipalities data are adjusted to match borrowing requirements reported by the BCB.

Table 10. Brazil: Financial Soundness Indicators, 2017-23

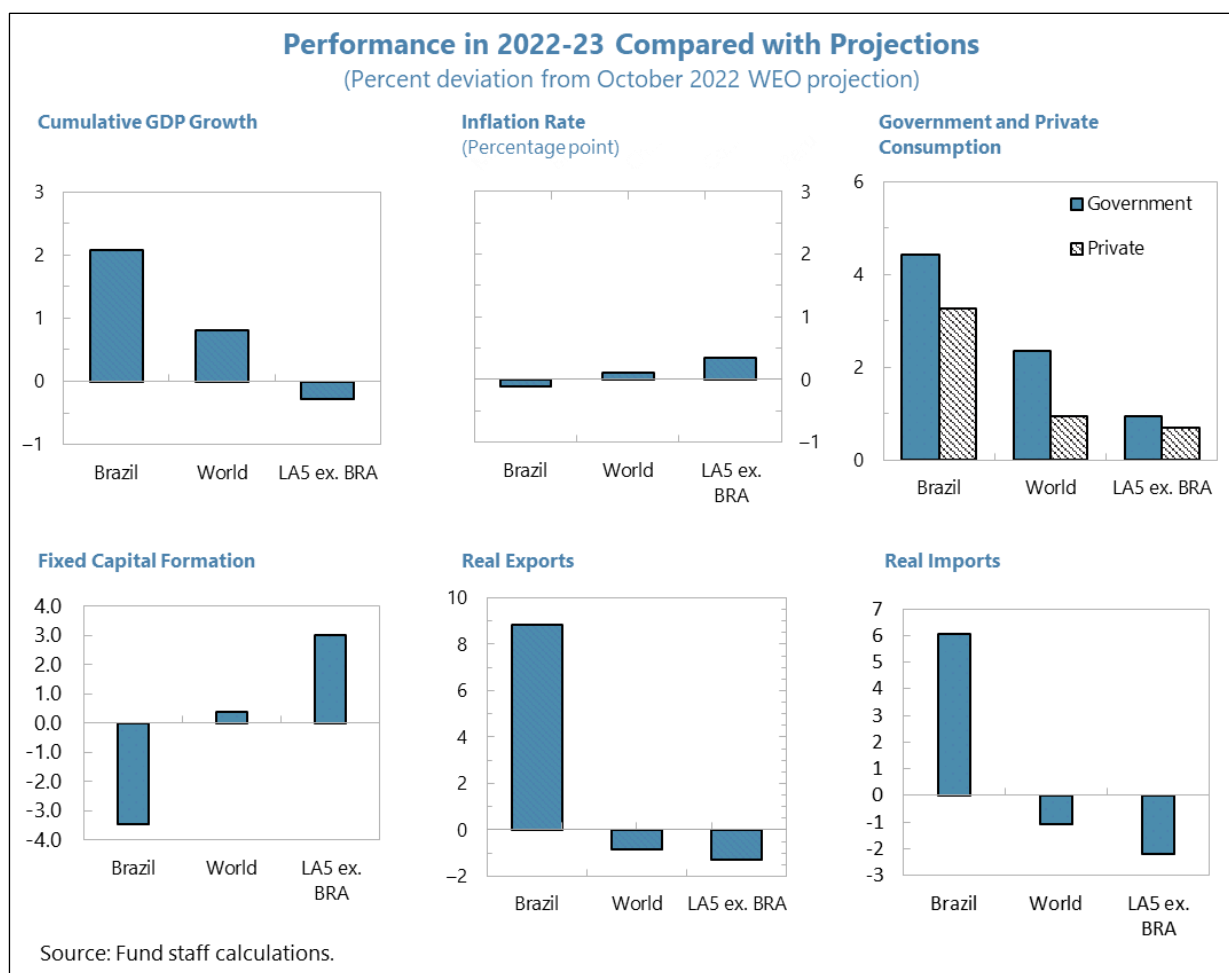
(In percent)

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|--|-------|-------|-------|-------|-------|-------|-------|
| Capital Adequacy | | | | | | | |
| Regulatory capital to risk-weighted assets | 19.5 | 19.5 | 19.4 | 19.1 | 18.4 | 17.5 | 17.9 |
| Regulatory Tier 1 capital to risk-weighted assets | 15.4 | 15.6 | 16.0 | 16.4 | 16.0 | 15.3 | 15.8 |
| Common Equity Tier 1 capital to risk-weighted assets | 14.6 | 14.5 | 14.9 | 15.2 | 14.8 | 14.2 | 14.8 |
| Tier 1 capital to assets | 8.8 | 9.1 | 9.6 | 8.7 | 8.8 | 8.8 | 8.9 |
| Gross asset position in financial derivatives to capital | 11.4 | 10.4 | 11.8 | 18.7 | 15.5 | 17.8 | 12.1 |
| Gross liability position in financial derivatives to capital | 12.1 | 12.0 | 14.1 | 20.5 | 15.8 | 16.8 | 12.0 |
| Non-performing loans net of provisions to capital | -12.1 | -12.6 | -12.4 | -16.6 | -13.3 | -13.7 | -11.7 |
| Asset Quality | | | | | | | |
| Non-performing loans to total gross loans | 2.9 | 2.6 | 2.7 | 1.9 | 2.1 | 2.6 | 2.8 |
| Provisions to Non-performing loans | 202.7 | 221.8 | 218.0 | 314.0 | 247.4 | 210.7 | 190.1 |
| Earnings and Profitability | | | | | | | |
| Return on assets | 1.8 | 2.2 | 2.0 | 1.9 | 2.4 | 2.1 | 1.6 |
| Return on equity | 12.1 | 12.6 | 15.8 | 11.7 | 14.9 | 15.3 | 13.7 |
| Non-interest expenses to gross income | 53.7 | 51.9 | 55.5 | 51.6 | 52.0 | 50.1 | 53.0 |
| Interest margin to gross income | 62.7 | 63.0 | 62.1 | 63.4 | 65.4 | 65.4 | 67.3 |
| Liquidity | | | | | | | |
| Liquid assets to short-term liabilities | 279.3 | 268.1 | 260.8 | 308.5 | 199.7 | 194.5 | 240.5 |
| Liquid assets to total assets | 14.5 | 14.2 | 13.6 | 16.3 | 12.7 | 11.7 | 13.8 |
| Liquidity coverage ratio | 200.6 | 216.7 | 221.5 | 229.0 | 173.9 | 169.8 | 184.6 |
| Net stable funding ratio | 0.0 | 121.7 | 123.3 | 124.6 | 119.6 | 119.1 | 120.3 |
| Net open position in foreign exchange to capital | 0.4 | 0.5 | 0.2 | 0.6 | 2.3 | 3.3 | 2.0 |
| Real Estate Markets | | | | | | | |
| Residential Real Estate Prices | -1.1 | 1.5 | 5.0 | 9.1 | 6.3 | 1.2 | 1.4 |
| Commercial Real Estate Prices | -4.1 | -2.6 | -2.6 | -1.2 | 0.0 | -0.4 | -0.6 |

Sources: Central Bank of Brazil; and Fund staff calculations.

Annex I. Economic Resilience During 2022-23: Insights from Forecast Errors¹

1. Brazil's economy has been surprisingly resilient during the disinflation process of the past two years. Real GDP growth performance has been stronger than envisaged, while inflation was slightly lower than expected. Compared with forecasts in the October 2022 WEO, cumulative real GDP growth during 2022-23 was stronger by over 2 percentage points. This growth over-performance was significantly greater than for the world economy and the median of other LA5 economies. Greater-than-expected real government and real private consumption drove the overperformance compared with forecasts, as for other economies. Brazil's real exports also grew more strongly than projected in the October 2022 WEO, amid record agricultural supply. Reflecting the strength in domestic demand, real imports also exceeded the projections, although to a lesser extent. By contrast, exports and imports in the rest of the world and in other LA5 economies on average slowed compared with forecasts. Meanwhile, investment in Brazil was slower than expected.



¹ This Annex was prepared by Daniel Leigh (WHD).

Annex II. FDI in Brazil: Developments and Drivers¹

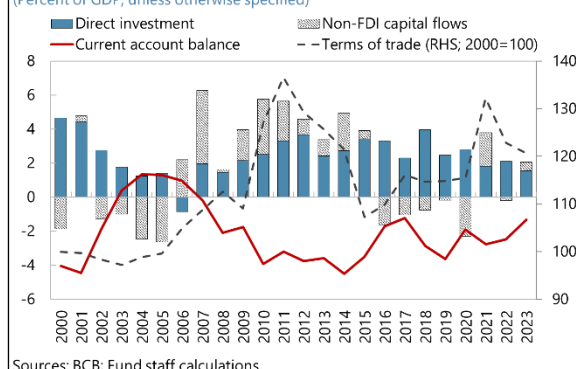
1. FDI in Brazil has risen since the Global Financial Crisis (GFC).

The average net FDI volume increased to 2.7 percent of GDP per year in 2010-23, doubling from an average of 1.3 percent of GDP in 2003-09.² In dollar terms, FDI increased by more than 250 percent on average during this period. The data from the United Nations Conference on Trade and Development (UNCTAD) showed that Brazil received an average of around 40 percent of annual FDI flows to Latin America and around 9 percent to Emerging Market and Developing Economies (EMDE) since the GFC.

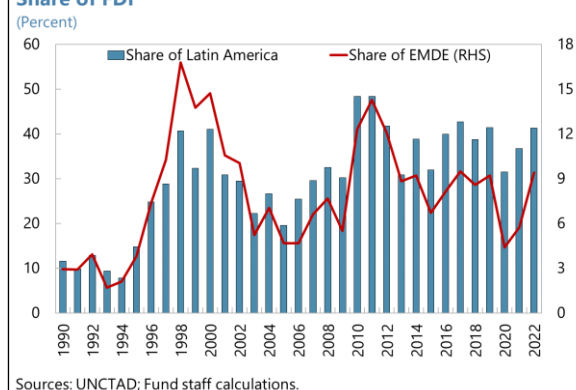
2. FDI dominated capital flows to Brazil and helped finance the country's current account deficits. Net FDI flows accounted for above 95 percent of total cumulative net capital flows in Brazil in 2010-23; while in gross terms, FDI inflows accounted for a lesser 85 percent of total cumulative capital inflows. After the commodity supercycle faded in the 2010s, Brazil's current account deficits widened to an average of 3.0 percent of GDP during 2010-22, compared with 0.2 percent during 2002-09. The increasing FDI flows in Brazil since the GFC helped to finance the widener current account deficits.

3. The sectors of oil and natural gas extraction as well as renewable energy received substantial FDI inflows. FDI inflows led to a continued increase in external liabilities. Its share in foreign liabilities in the Net International Investment Position (NIIP) has doubled during 2002-23 (from around 30 percent in 2002 to

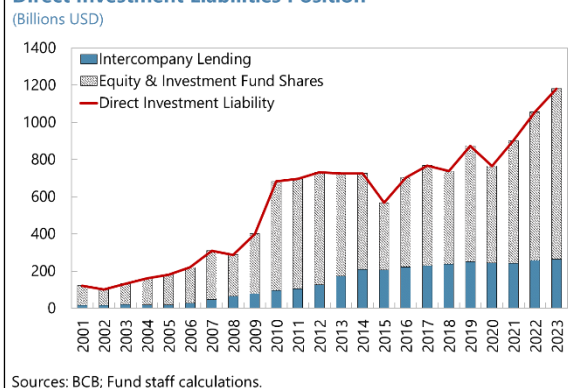
Capital Flows, Current Account Balance, and Terms of Trade
(Percent of GDP; unless otherwise specified)



Share of FDI
(Percent)



Direct Investment Liabilities Position
(Billions USD)

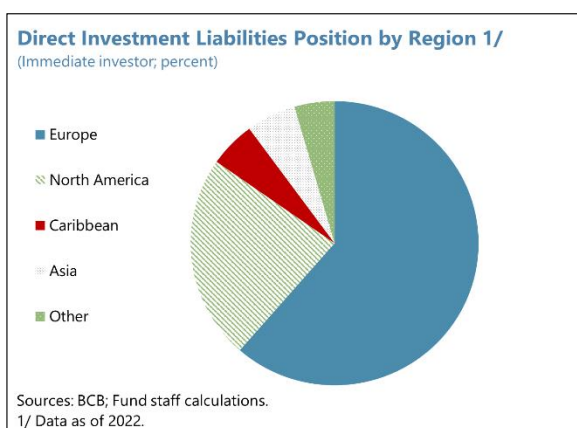
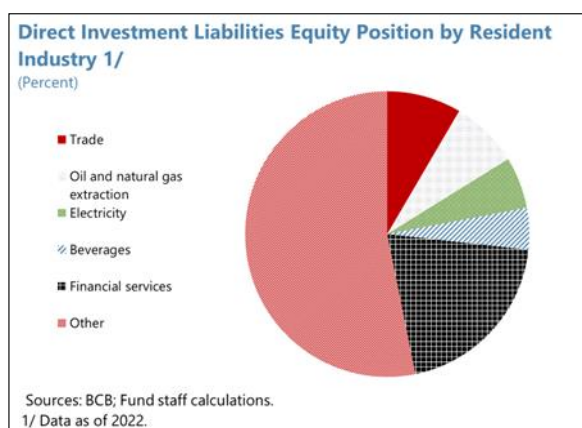


¹ This Annex was prepared by Yiqun Wu (SPR).

² There was a methodological change in FDI series, with reinvested earnings included since 2010.

around 60 percent in 2023)³. Equity and investment fund shares, more than intercompany lending, were the driver of the increase in FDI liabilities. Among industries, financial services (19 percent), oil and natural gas extraction (7.4 percent), and electricity (including renewable energy; 5.6 percent), have received the bulk of FDI inflows.

4. Investors from Europe and North America accounted for most of the investor base in Brazil. By the immediate investor criterion, Europe remained the region with the largest direct investment position in Brazil, accounting for about 62 percent of the total in 2022, following by North America (about 23 percent). The main European immediate investors are from its financial centers, including the Netherlands (accounting for around 41 percent of the total), followed by Luxembourg. However, their share is lower by the ultimate controlling criterion. By the latter criterion, countries that host corporate headquarters, such as the United States, Spain, United Kingdom, France, and China, held higher direct investment equity positions in Brazil than suggested by the immediate investor criterion.



5. The “push versus pull” framework is used to study the drivers of FDI inflows. The empirical strategy is based on a panel analysis of 28 emerging market economies with country fixed effects, using quarterly observations from 1990Q1 through 2023Q4. The analysis focuses on FDI inflows, which are scaled by domestic GDP. Specifically, the magnitude of FDI inflows to country i at time t , $K_{i,t}$, is modelled as a function of vectors of global push factors and domestic pull factors:

$$K_{i,t} = \alpha_0 K_{i,t-1} + \alpha_1 \text{Push Factors}_{i,t} + \alpha_2 \text{Pull Factors}_{i,t} + \eta_i + \varepsilon_{i,t}$$

where η_i captures the fixed effects in country i . “Push factors” are the determinants that affect the external supply conditions, such as global risk aversion, commodity prices, supply of global liquidity, US corporate spread, and yield gap. “Pull factors” are the demand-side conditions that reflect the characteristics of each recipient country that attract FDI inflows, such as macroeconomic fundamentals and policies (growth and inflation differentials vis-à-vis the U.S., trade openness,

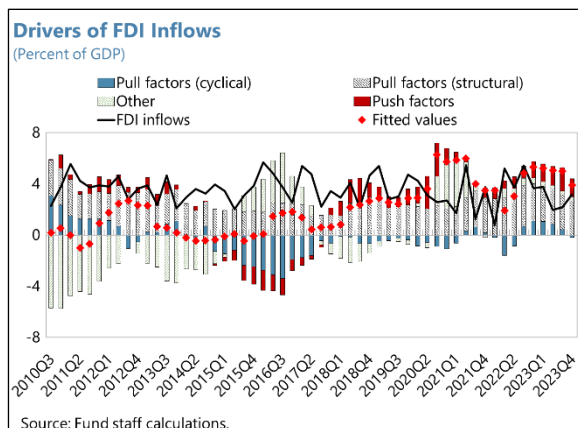
³ The Banco Central do Brasil’s March 2021 [Inflation Report](#) provided an overview of the direct investment liabilities and its behavior during the COVID-19 pandemic and included evidence that the financing strategy of multinational companies helped explain short-term movements of this variable.

capital account openness, FX level of reserves, and exchange rate regime), and the institutional framework (institutional quality and financial development indices).⁴

6. The analysis suggests that Brazil's pull factors, particularly structural characteristics, have played an increasing role in attracting FDI inflows and are now the main driver.

Global risk aversion was an important driver in a few capital flow episodes, with low global risk aversion leading to high FDI inflows. Other global factors, including U.S. corporate spreads and the U.S. yield gap, also influenced FDI inflows. However, domestic pull factors seemed to account for a larger portion of FDI inflows over time. Domestic structural factors (such as trade openness, capital account openness, institutional quality, and income per capita) helped to attract more FDI

inflows than cyclical factors (growth and inflation differentials vis-à-vis the U.S.). Indeed, the analysis comparing the pre- and post-GFC periods shows higher coefficients for trade openness and financial market development as determinants of FDI inflows. Since the GFC, Brazil has made important strides in trade liberalization (including lowering import tax rates and reducing non-tariff barriers), progressed in financial market development, and advanced regulatory reforms. This progress on multiple fronts has increased foreign appetite for investing in Brazil.



⁴ The analysis follows existing literature for commonly used variables in the push-pull framework. Additional considerations, such as infrastructure, geography, and natural resource base, will be explored in future studies.

Annex III. External Sector Assessment¹

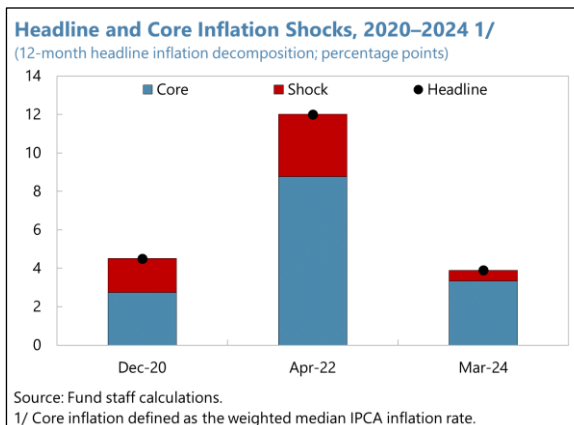
| | | | | | | |
|---|--|-------------|---------------------|------------------|-------------------|------------------|
| <p>Overall Assessment: <i>The external position in 2023 was broadly in line with the level implied by medium-term fundamentals and desirable policies.</i> The current account (CA) deficit narrowed to 1.4 percent of GDP in 2023 and is expected to remain around 1.5 percent of GDP over the medium term as oil exports increase and net public saving improves. Risks to Brazil's external position over the medium term relate to uncertainties to global financial conditions and insufficient progress on domestic reforms.</p> <p>Potential Policy Responses: Policies that would help keep the CA in line with its norm include efforts to raise national saving, providing room for a sustainable expansion in investment. Fiscal consolidation should continue contributing to increase net public saving. Structural reforms that improve efficiency and reduce the cost of doing business would help strengthen competitiveness. Industrial policies should remain narrowly targeted to specific objectives where externalities or market failures prevent effective market solutions, avoid increasing barriers to trade and investment, and not favor domestic producers over imports.</p> | | | | | | |
| Foreign Asset and Liability Position and Trajectory | <p>Background. Brazil's NIIP dropped to -44.9 percent of GDP in 2023, from -42.2 percent of GDP in 2022, partly reflecting continued FDI and portfolio inflows. The NIIP is projected to be below -40 percent of GDP over the medium term, in line with projected CA deficits offset by robust nominal GDP growth. FDI will continue to account for more than half of all liabilities. At the end of 2023, external debt declined to 33.7 percent of GDP and 208 percent of exports, from around 35 percent of GDP and 200 percent of exports in 2022.</p> <p>Assessment. The NIIP has been negative since the series was first published in 2001. Over the medium term, gross external financing needs are moderate at below 10 percent of GDP annually, with capital flows and the exchange rate sensitive to global financing conditions.</p> | | | | | |
| | 2023 (% GDP) | NIIP: -44.9 | Gross Assets: 46.5 | Res Assets: 16.3 | Gross Liab.: 91.4 | Debt Liab.: 33.7 |
| Current Account | <p>Background. The CA deficit narrowed to 1.4 percent of GDP in 2023 from 2.5 percent in 2022, on the back of a sizable trade balance surplus of 3.7 percent of GDP (compared with 2.3 percent in 2022). The record-high trade surplus (owing to strong agriculture and oil exports and lackluster imports) reflected partly the structural change in the export sector and was offset by high deficits in transport services and primary income related to profits and dividends. From a saving-investment perspective, the CA deficit reflects the saving-investment deficit of the public sector partially offset by the saving-investment surplus of the private sector. The CA deficit is expected to remain around 1.5 percent of GDP over the medium term supported by higher oil exports and improved net public saving.</p> <p>Assessment. In 2023 the cyclically adjusted CA balance was -1.7 percent of GDP, and EBA estimates suggest a cyclically adjusted CA norm of -1.9 percent of GDP. IMF staff estimate the CA gap to be in the range of -0.4 and 0.7 percent of GDP, with a midpoint of 0.2 percent of GDP. EBA-identified policy gaps are estimated at -0.4 percent of GDP, reflecting positive credit growth and the more expansionary fiscal policy stances in Brazil relative to trading partners.</p> | | | | | |
| | 2023 (% GDP) | CA: -1.4 | Cycl. Adj. CA: -1.7 | EBA Norm: -1.9 | EBA Gap: 0.2 | Staff Adj.: 0.0 |
| Real Exchange Rate | <p>Background. Continuing the appreciation trend in 2020-22 (by around 8 percent), the REER appreciated by 4.6 percent in 2023 compared to the 2022 average, below the NEER appreciation of 11.6 percent, reflecting relatively low inflation in Brazil compared with its major trading partners. As of April 2024, the REER had depreciated by 0.5 percent relative to the 2023 average.</p> <p>Assessment. The IMF staff CA gap implies a REER gap of -1.7 percent in 2023 (applying an estimated elasticity of 0.12). The REER index model suggests a REER gap of -25.1 percent, while the REER level model suggests a REER gap of -11.2 percent. Consistent with the staff CA gap, staff assesses the REER gap to be in the range of -5.9 to 2.5 percent, with a midpoint of -1.7 percent.</p> | | | | | |
| | | | | | | |
| Capital and Financial Accounts: | <p>Background. Brazil continues to attract sizable capital flows. Net FDI flows continued to finance the CA deficit, averaging 2.6 percent of GDP during 2015-22 (when CA deficits averaged 2.8 percent) before dropping to 1.7 percent of GDP in 2023. Portfolio investment registered net inflows of 0.3 percent of GDP.</p> | | | | | |
| | <p>Flows and Policy Measures</p> <p>Assessment. The composition of capital flows is expected to have a favorable risk profile over the medium term, with positive net FDI inflows (above 1.5 percent of GDP) outweighing negative portfolio outflows (around 0.2 percent of GDP) and debt liabilities increasingly denominated by FDI liabilities. Nevertheless, uncertainties related to tighter global financial conditions and insufficient progress on reforms pose downside risks to capital flows.</p> | | | | | |
| FX Intervention and Reserves Level | <p>Background. Brazil has a floating exchange rate. While FX interventions in 2022 relied on spot, repo, and FX swap markets to ensure smooth market functioning, the authorities did not intervene in the FX markets in 2023 amidst resilient FX performance. The outstanding stock of the FX swap, a non-deliverable future settled in local currency, stayed around US\$100 billion since 2022. International reserves increased by US\$30 billion and reached US\$355 billion at end-2023, mostly owing to valuation effects.</p> | | | | | |
| | <p>Assessment. The flexible exchange rate has been an important shock absorber. Reserves remain adequate relative to various criteria, including the IMF's reserve adequacy metric (130 percent as of end-2023) and serve as insurance against external shocks. Intervention should be limited to alleviating disorderly FX market conditions.</p> | | | | | |

¹ This Annex was prepared by Yiqun Wu (SPR).

Annex IV. The Rise and Fall of Inflation Since 2020: A Phillips Curve Perspective¹

1. Staff analysis suggests that the decline of inflation from its 2022 peak reflects the fading of headline shocks and falling core inflation.

The starting point is a decomposition of headline IPCA inflation into core inflation and headline inflation shocks (deviations from core). The analysis measures core inflation using the weighted median IPCA inflation rate.² Headline inflation shocks arise from large price changes in particular industries. The figure shows this decomposition for 12-month inflation. Both positive headline shocks (grey bars) and rising core inflation (blue bars) contributed to the rise in 12-month inflation through its peak in April 2022.



2. The analysis explains core inflation with a variation on a Phillips curve that allows for nonlinearities.

The equation estimated is, following the approach of Dao and others (2023):³

$$(1) \quad \pi = \pi^e + f(Y) + g(H) + \varepsilon$$

where π is the monthly annualized core (weighted median IPCA) inflation rate; π^e is expected inflation as measured by ten-year forecasts from Consensus Economics; Y is the average of the IMF staff estimate of the output gap over the current and previous four quarters (the available quarterly path is interpolated to obtain a monthly series); H is the average of headline inflation shocks over the current and previous 11 months, capturing the pass-through of these shocks to core inflation; and $f(\cdot)$ and $g(\cdot)$ are quadratic functions, which allow for non-linearities in a flexible way.⁴ This equation fits the behavior of monthly annualized core inflation well. As Table 1 reports, estimates for the pre-pandemic sample (January 2007–December 2019) and the full sample ending February have R-squared statistics of 44 percent and 49 percent, respectively. The slope with respect to the output gap is 0.3 and is highly statistically significant. It has changed little from the pre-pandemic sample

¹ This Annex was prepared by Daniel Leigh (WHD). Melih Firat (APD), Swarnali Hannan, and Gabriel Moura (both WHD) provided inputs for demand-supply component analysis.

² For the methodology, see Dao, Gourinchas, Leigh, and Mishra. 2024. "Understanding the International Rise and Fall of Inflation Since 2020." Paper presented at National Bureau of Economic Research conference Inflation in the COVID Era and Beyond, Cambridge, MA, May 16–17, 2024.

³ See Dao, Mai Chi, Allan Dizioli, Chris Jackson, Pierre-Olivier Gourinchas, and Daniel Leigh. 2023. "Unconventional Fiscal Policy in Times of High Inflation." IMF Working Paper 23/178, International Monetary Fund, Washington, DC.

⁴ The approach measures expected inflation with long-term survey forecasts following studies such as Hazell and others. 2022. "The Slope of the Phillips Curve: Evidence from U.S. States." *The Quarterly Journal of Economics*, Volume 137, Issue 3, August 2022. Near-term inflation expectations are an important channel for the propagation of shocks, with implications for both wage and price setting, and are reflected in the $f(\cdot)$ and $g(\cdot)$ functions.

ending in 2019. The chart, derived from the Phillips curve estimates reported in the table, illustrates the relation, which implies that a 1 percentage point rise in the output gap comes with a 0.3 percentage point rise in inflation. The pass-through coefficient point estimates have changed little from the pre-pandemic sample, but their statistical significance has increased, possibly reflecting the greater variation in the data, with the large relative price shocks during the pandemic. Non-linearities are evident in the pass-through coefficient as the quadratic term is positive: larger positive headline-inflation shocks have a proportionately stronger relation with core inflation, in line with a number of models, although more research is needed on the sources of such nonlinearities.⁵

Table 1. Brazil: Phillips Curve Estimates: Median Inflation

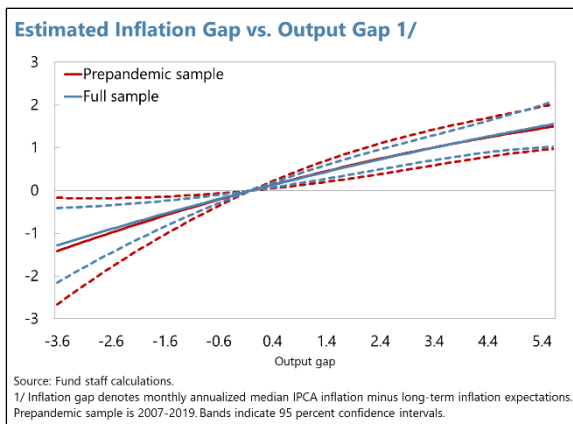
| | (1) 2007-2019 | (2) 2007-2024 |
|--------------------|---------------------|---------------------|
| Output gap | 0.344*** (0.114) | 0.325*** (0.075) |
| Output gap-squared | -0.014 (0.018) | -0.008 (0.015) |
| H | 0.442 (0.416) | 0.327** (0.134) |
| H-squared | 0.197 (0.162) | 0.286*** (0.062) |
| Observations | 150 | 199 |
| R-squared | 0.438 | 0.491 |

Source: Fund staff calculations.

Note: Dependent variable is weighted median IPCA inflation (monthly seasonally adjusted annualized rate) minus long-term (Consensus Economics) expectations. Output gap denotes 12-month average of IMF staff output gap estimate. "H" denotes headline inflation shock (12-month average). Newey-West standard errors with twelve lags (monthly data) in parentheses. ***p < .01, **p < .05, and *p < .10

3. The analysis finds a particularly strong contribution of energy price fluctuations to headline inflation shocks in Brazil.

The bivariate relation between monthly headline inflation shocks and energy price inflation, measured as monthly energy price inflation minus median inflation, has an R-squared statistic of 38 percent for the 2020-24 period. The prominent role of energy price inflation is also found for other economies (see Dao and others 2023). The analysis for Brazil also finds a significant role for the rise and decline of supply chain problems (as captured by the backlogs of work index from the

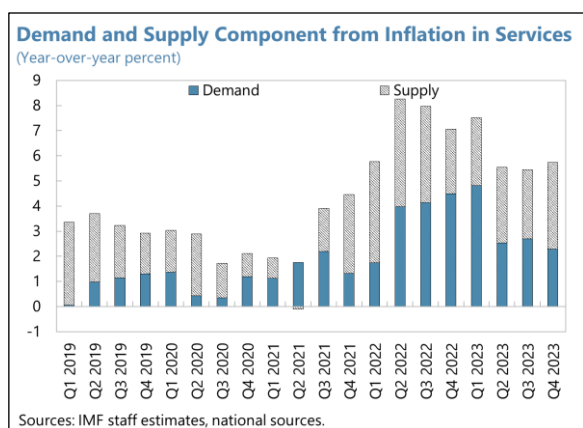
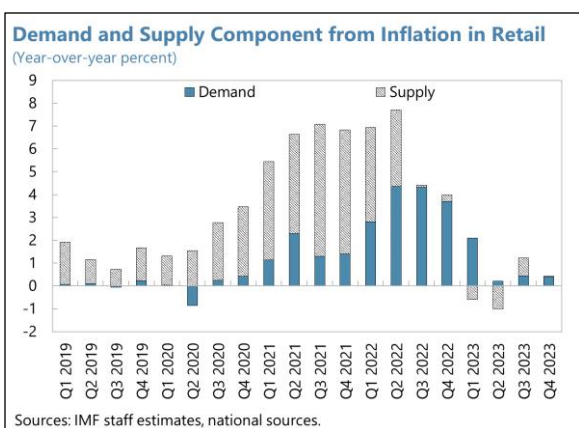


⁵ Similar results are found for other countries—see Dao and others (2023).

information services firm IHS Markit Economics) which has a bivariate R-squared statistic with monthly headline inflation shocks of 17 percent.

4. The analysis concludes that most of the overall rise and fall in headline inflation during 2020-2024 reflects the onset and subsequent unwinding of headline inflation shocks, notably to the price of energy, and their pass-through into core inflation. The chart in the main text illustrates this result by deriving the twelve-month average of headline shocks explained by the aforementioned analysis and using them to derive the impact on the core inflation gap using the estimated Phillips curve results reported in Table 1. The analysis also indicates that medium-term inflation expectations have been broadly stable and contributed little to inflation dynamics, and that the contribution from overall aggregate demand movements as measured by the output gap has—so far—been limited.

5. Complementary analysis confirms that supply-side factors have played a central role in driving inflation movements in Brazil. The role of supply factors is confirmed by decomposing inflation into demand and supply components. Brazil-specific demand and supply components of retail and services inflation are computed from 2008 onwards using the methodology of [Firat and Hao \(2023\)](#) where inflation in a given sector and time period is classified as either demand- or supply-driven based on the signs of the residuals from a vector autoregression. If the residuals in the price and quantity equations have the same sign, inflation for that item is regarded as demand-driven, while opposite signs indicate a supply-driven component. In other words, the underlying motivation is that demand shocks move prices and quantities in the same direction, while supply shocks move them in opposite directions. The analysis suggests that the surge in retail (goods) inflation was predominantly driven by supply factors, while that of services inflation reflected a mix of demand and supply factors.



Annex V. Risk Assessment Matrix¹

| Risks | Likelihood | Impact | Policy Response |
|---|---------------|---|--|
| Domestic Risks | | | |
| Downside Risks | | | |
| More-severe-than-expected Impact of Rio Grande do Sul Flood Calamity , resulting in further supply disruptions and destruction of productive capacities. | Medium | Medium . Greater-than-expected supply disruptions could result in higher inflationary pressures and negatively impact growth and the fiscal accounts. | Monetary policy should remain vigilant and flexible in case of increased price pressures. The government could provide targeted support to vulnerable households who are victims of the flood calamity. A well targeted package for the recovery and reconstruction can help offset some negative effects on growth. Over the longer run, additional initiatives on flood prevention, mitigation, and adaptation are warranted. |
| Slower-than-envisaged Medium-term Fiscal Consolidation . Identified measures deliver less than expected fiscal consolidation. | High | Medium . Medium-term inflation expectations remain unanchored, slowing the decline of policy rates toward neutral levels. Risk premia increase, raising borrowing costs. Currency depreciation occurs amid lower investor sentiment. Investment and growth are lower than projected. | Monetary policy should remain vigilant in case inflationary pressures materialize. Efforts to strengthen the fiscal position, supported by an enhanced fiscal framework, a further broadening of the tax base, and reforms that tackle spending rigidities should accelerate, while protecting the most vulnerable through targeted support. |
| Extreme Climate Events . Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability. | Medium | Medium . The electricity sector is dependent on hydropower and thus prone to swings in electricity production and cost increases. Given geography, as well as less underdeveloped infrastructure particularly in townships, frequent mudslides destroy buildings and livelihoods. | The government can provide targeted support to mitigate the impact of natural disasters on the most vulnerable and establish funds for reconstruction. Policies should aim to diversify energy sources by further broadening solar and wind energy; adjust grids and storage capacity for electricity; invest in safer infrastructure; and protect biomes to conserve precipitation patterns as much as possible. Strengthened early warning systems could help mitigating risks from mud slides and flooding. |
| Upside Risks | | | |
| Stronger-than-expected Household Consumption , supported by the tight labor market and rising real income. | Medium | Medium . Higher real GDP growth from boost in private consumption, improvement in poverty and social outcomes if this percolates to lower income households. Tighter labor markets and higher real wage growth slow the decline in inflation. | Monetary policy should remain vigilant should inflation risks materialize and calibrate policy to incoming data. |

¹ This Annex was prepared by Bunyada Laoprapassorn (WHD). The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

| Risks | Likelihood | Impact | Policy Response |
|--|------------|---|---|
| Faster-than-expected Implementation of Structural Reform Agenda , including in Growth Acceleration Program and investments in green growth opportunities. | Medium | High . Higher-than-expected boost in medium-term growth through improved productivity and investment. Improvement in social outcome and better job opportunities. | Policies to upgrade skills and education, particularly in an inclusive manner, will ensure more sustainable and inclusive growth. Policies (e.g., better childcare provision) would help to improve female labor force participation. |
| Global Risks | | | |
| Downside Risks | | | |
| Intensification of Regional Conflict(s) . Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows. | High | Medium . Lower investment confidence and broader EM capital outflow pressures could give rise to a repricing of risk assets, dent growth, and increase depreciation and inflationary pressures. However, exports could benefit in the near-term due to positive terms-of-trade effects from commodity price increases. | Exchange rate flexibility should remain instrumental to absorb shocks. FX intervention could be used when exchange rate flexibility is associated with costly frictions (e.g., due to shallow FX markets) but should not substitute for warranted adjustments of macroeconomic policies. Introducing comprehensive outflow CFMs in line with the Fund's Institutional View could be considered in imminent crisis circumstances. However, this should not substitute for any warranted macroeconomic adjustments. |
| Commodity Price Volatility . A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability. | High | Low . Low and volatile oil prices will compress investment, primarily by Petrobras, and reduce growth. On the other hand, high and volatile oil prices could increase inflation pressures in an unpredictable manner. | Higher oil prices should be allowed to pass through to consumers, accompanied by targeted support for the poor as needed. Monetary policy needs to remain vigilant in case there is need to pause the easing cycle to contain second-round inflationary effects of prolonged volatile and high commodity prices. |
| Deepening Goeconomic Fragmentation . Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth. | High | Medium . Decline in global economic productivity and higher input costs could weaken economic activity. However, Brazil's trade-to-GDP ratio is relatively low, which would contain negative growth effects. Possible nearshoring effects from North America could mitigate some of the downside growth effects. | The government should accelerate structural reforms and policies related to upgrading skills and education to ensure that the economy can adjust swiftly to shift in trade and FDI patterns and lower global economic growth. |

| Risks | Likelihood | Impact | Policy Response |
|--|------------|---|---|
| <p>Abrupt Global Slowdown. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs.</p> <ul style="list-style-type: none"> • China: Sharper-than-expected contraction in the property sector weighs on private demand, further amplifies local government fiscal strains, and results in disinflationary pressures and adverse macro-financial feedback loops. • Europe: Intensifying fallout from Russia's war in Ukraine, supply disruptions, tight financial conditions, and real estate market corrections exacerbate economic downturn. • U.S.: Amid tight labor markets, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in more abrupt financial, housing, and commercial real estate market correction. | Medium | <p>Medium. A sharp decline in global economic activity could undermine consumer and investment confidence and dampen trade, in particular if the slowdown occurs in Brazil's major trading partners. However, Brazil is relatively closed, which would contain negative growth effects.</p> | <p>The pace of monetary policy easing could be accelerated if incoming data provide strong evidence of a sharp disinflationary force. The government could provide targeted social support for the vulnerable within the budget envelope. Fiscal stimulus can be considered in a severe downturn scenario while maintaining debt sustainability.</p> |
| <p>Monetary Policy Miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.</p> | Medium | <p>Medium. Spillovers could be more limited in Brazil than peers, given Brazil's high domestic real rates, net FX creditor status, and limited reliance on portfolio flows.</p> | <p>Exchange rate flexibility should remain instrumental to absorb shocks. Monetary policy should be guided by incoming data. Liquidity support may need to be provided if banks come under pressure. Targeted support could be provided to vulnerable households while a tighter fiscal stance should be adopted to support disinflation efforts.</p> |
| <p>Systemic Financial Instability. High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.</p> | Medium | <p>Medium. Systemically important banks are adequately capitalized and liquid with securities' portfolios mostly marked-to-market and interest-rate risk hedged appropriately. The authorities' stress tests suggest the banking system would be resilient to a variety of risks, including a significant deterioration in credit quality.</p> | <p>The authorities are appropriately taking steps to pass resolution legislation as recommended in the 2018 FSAP to ensure that any problem banks are addressed efficiently and swiftly.</p> |
| <p>Cyberthreats. Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.</p> | Medium | <p>High. Cyberattacks could disrupt economic activity and damage the financial sector given the high degree of digitalization in Brazil; resulting loss of confidence could hinder progress on digitalization.</p> | <p>Continue to extensively monitor risks and regularly perform cybersecurity tests. Further build resilience by strengthening cybersecurity frameworks and ensuring robust cybersecurity laws.</p> |

Annex VI. Data Issues¹

Table 1. Brazil: Data Adequacy Assessment for Surveillance

| Table 1. Brazil: Data Adequacy Assessment for Surveillance | | | | | | | |
|--|--|--------|-------------------------------|----------------------------|-----------------------------------|----------------------------|---------------|
| Data Adequacy Assessment Rating 1/ | | | | | | | |
| A | | | | | | | |
| Questionnaire Results 2/ | | | | | | | |
| Assessment | National Accounts | Prices | Government Finance Statistics | External Sector Statistics | Monetary and Financial Statistics | Inter-sectoral Consistency | Median Rating |
| | A | A | A | A | A | A | A |
| Detailed Questionnaire Results | | | | | | | |
| Data Quality Characteristics | | | | | | | |
| Coverage | A | A | B | A | A | | |
| Granularity 3/ | A | | A | A | A | | |
| | | | A | | A | | |
| Consistency | | | B | A | | A | |
| Frequency and Timeliness | A | A | A | A | A | | |
| Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank. | | | | | | | |
| 1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics. | | | | | | | |
| 2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF Review of the Framework for Data Adequacy Assessment for Surveillance, January 2024, Appendix I). | | | | | | | |
| 3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators. | | | | | | | |
| A | The data provided to the Fund is adequate for surveillance. | | | | | | |
| B | The data provided to the Fund has some shortcomings but is broadly adequate for surveillance. | | | | | | |
| C | The data provided to the Fund has some shortcomings that somewhat hamper surveillance. | | | | | | |
| D | The data provided to the Fund has serious shortcomings that significantly hamper surveillance. | | | | | | |
| Rationale for staff assessment. Data is generally timely, comprehensive, and accurate for surveillance across all sectors. Nevertheless, shortcomings exist in some areas of fiscal data. For example, there is no centralized reporting of guarantees or PPPs, and the stock of judicial claims, albeit published as separate statistic on the Brazilian Independent Fiscal Institution (IFI) website, is not recorded under contingent liabilities or some other form in the Treasury's debt statistics. Materialized but postponed <i>precatórios</i> —now settled in the Dec 2023 payment—had not been reflected in the Treasury's debt statistics. Additionally, the authorities document one-off revenues and expenditures only partially, which led to a different understanding of the fiscal impulse by staff and the authorities in the past. | | | | | | | |

¹ This Annex was prepared by Bunyada Laoprapassorn (WHD).

Changes since the last Article IV consultation. The authorities recently published an analysis on structural revenues from commodities, which helps to better filter out the cycle.

Corrective actions and capacity development priorities. The authorities are working to, in consultation with the IMF, improve the data quality and methodological compilation of government finance statistics for better alignment with best international standards and practices (including alignment with GFSM 2014).

Use of data and/or estimates different from official statistics in the Article IV consultation. Staff do not use data and/or estimates different from official statistics.

Other data gaps. Not applicable for Brazil.

Table 2. Brazil: Data Standards Initiatives

Brazil adheres to the Special Data Dissemination Standard (SDDS) Plus since November 2019 and publishes the data on its [National Summary Data Page](#). The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (<https://dsbb.imf.org/>).

Table 3. Brazil: Table of Common Indicators Required for Surveillance
(As of June 7, 2024)

| | Data Provision to the Fund | | | | Publication under the Data Standards Initiatives through the National Summary Data Page | | | |
|--|----------------------------|---------------|--------------------------------|-------------------------------------|---|---------------------|------------------------------------|---------------------|
| | Date of Latest Observation | Date Received | Frequency of Data ⁶ | Frequency of Reporting ⁶ | Expected Frequency ^{6,7} | Brazil ⁸ | Expected Timeliness ^{6,7} | Brazil ⁸ |
| Exchange Rates | June 2024 | 7-Jun-24 | D | D | D | ... | ... | ... |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹ | May 2024 | Jun-24 | M | M | M | M | 1W | 5D |
| Reserve/Base Money | May 2024 | May-24 | D | W | M | M | 2W | 2W |
| Broad Money | April 2024 | May-24 | M | M | M | M | 1M | 4W |
| Central Bank Balance Sheet | April 2024 | May-24 | M | M | M | M | 2W | 2W |
| Consolidated Balance Sheet of the Banking System | March 2024 | Apr-24 | M | M | M | M | 1M | 4W |
| Interest Rates ² | May 2024 | May-24 | M | M | D | ... | ... | ... |
| Consumer Price Index | April 2024 | May-24 | M | M | M | M | 1M | NLT 15D |
| Revenue, Expenditure, Balance and Composition of Financing ³ –General Government ⁴ | March 2024 | May-24 | M | M | A/Q | A/Q | 2Q/12M | 2Q/1Q |
| Revenue, Expenditure, Balance and Composition of Financing ³ –Central Government | April 2024 | Jun-24 | M | M | M | M | 1M | 1M |
| Stocks of Central Government and Central Government-Guaranteed Debt ⁵ | April 2024 | May-24 | M | M | Q | M | 1Q | 1M |
| External Current Account Balance | April 2024 | May-24 | M | M | Q | M | 1Q | NLT 4W |
| Exports and Imports of Goods and Services | April 2024 | May-24 | M | M | M | M | 8W | NLT 3W |
| GDP/GNP | Q1 2023 | Jun-24 | Q | Q | Q | Q | 1Q | 70D |
| Gross External Debt | Q1 2024 | May-24 | Q | Q | Q | Q | 1Q | NLT 90D |
| International Investment Position | Q1 2024 | May-24 | Q | Q | Q | Q | 1Q | 3M |

¹ Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

² Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

⁷ Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

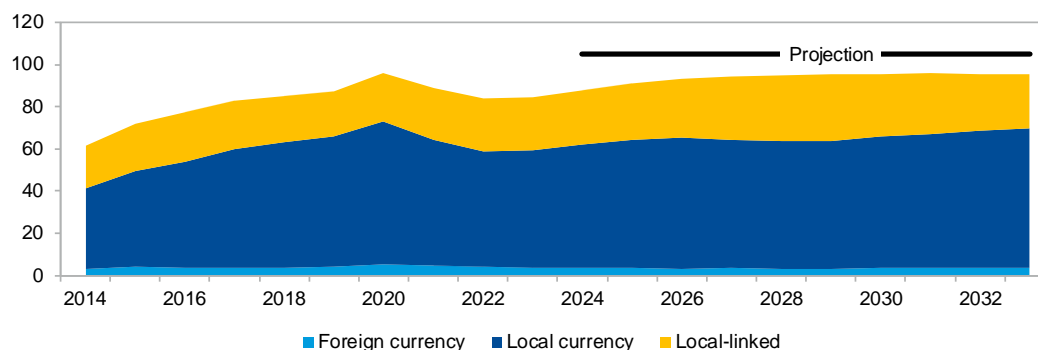
⁸ Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (<https://dsbb.imf.org/>). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "...".

Annex VII. Debt Sustainability Analysis¹

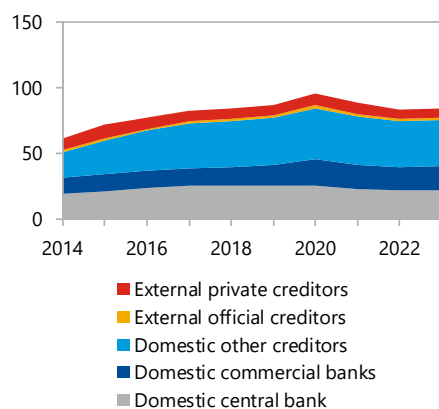
Figure 1. Brazil: Risk of Sovereign Stress

| Horizon | Mechanical signal | Final assessment | Comments |
|--|-----------------------------|------------------|--|
| Overall | ... | Moderate | The overall risk of sovereign stress is moderate, reflecting moderate levels of vulnerability in the medium-, and long-term horizons. |
| Near term 1/ | ... | ... | ... |
| Medium term | High | Moderate | Despite the high levels of debt, medium-term risks are assessed as moderate under staff's baseline, on the basis of the overwhelmingly domestic investor base, large liquid assets held by the treasury and the substantial Central Bank holdings of federal securities that mitigate refinancing risks. These mitigating factors allow for smoothing the impact of any temporary shock. |
| Fanchart | High | ... | |
| GFN | Moderate | ... | |
| Stress test | Comm. Prices Nat. Diast. | ... | |
| Long term | ... | Moderate | Over the long-term, risks are assessed as moderate. Rollover risks are mitigated by the country's capabilities to implement proactive debt management. Increases in aging-related expenditures on health and social security are expected to be addressed through reforms that tackle the sizeable deficits of the social security regimes. |
| Sustainability assessment 2/ | | | |
| Debt stabilization in the baseline | | | No |
| DSA Summary Assessment | | | |
| <p>Commentary: Overall risk of stress is moderate. Under the baseline scenario, debt is projected to continue increasing in the medium-term, before stabilizing around 95 percent of GDP in the extended projection horizon, contingent on gradual fiscal adjustment. Medium-term liquidity risks as analyzed by the GFN module are moderate given significant cash buffers (15 percent of GDP) and a large share of the general government gross debt (almost 25 percent of the total) held by the central bank that poses negligible refinancing risks. These mitigating factors could also allow to smooth the impact of any temporary shock. Debt projections are highly sensitive to changes in interest rates given the high share of short-term and variable coupon debt. Over the longer run, Brazil should continue with reforms to tackle risks arising from population aging which will deepen the already sizable deficits of the social security regimes. As judicial claims pose an important medium-term risk to debt sustainability, the authorities' ongoing efforts to reduce the stock of claims and the VAT reform recently approved would be key to mitigate this risk.</p> | | | |
| <p>Source: IMF staff estimates.</p> <p>Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.</p> <p>1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.</p> <p>2/ A debt sustainability assessment is optional for surveillance-only cases.</p> | | | |

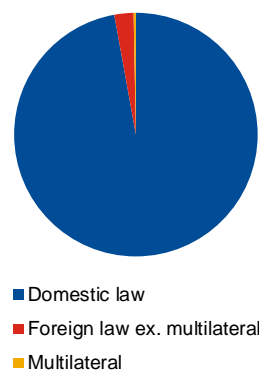
¹ This Annex was prepared by Jean Francois Clevy (WHD).

Figure 3. Brazil: Public Debt Structure Indicators**Debt by Currency (Percent of GDP)**

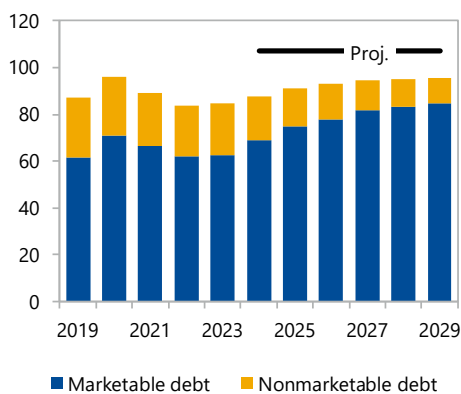
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)

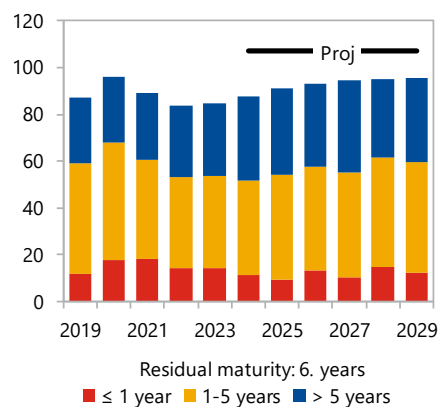
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (Percent)

Note: The perimeter shown is central government.

Debt by Instruments (Percent of GDP)

Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)

Note: The perimeter shown is general government.

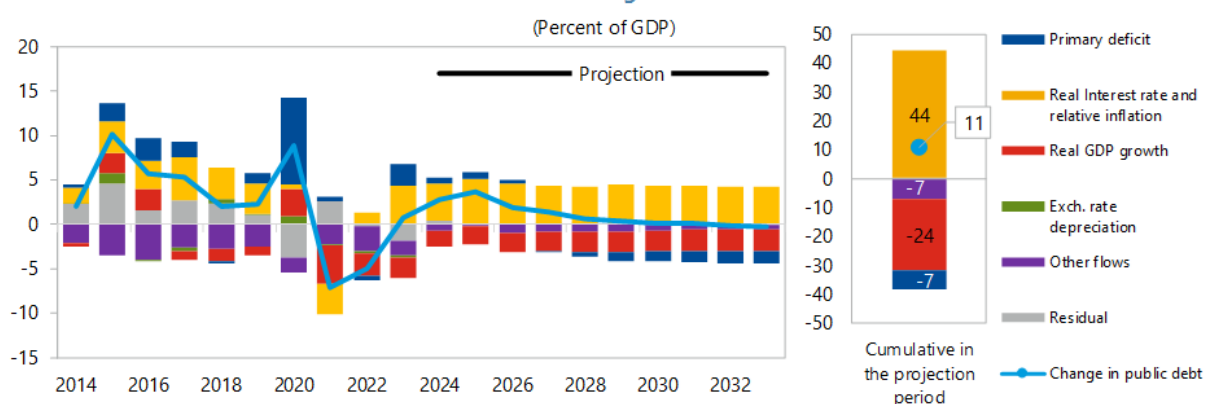
Commentary: Debt composition is favorable with small amounts of FX and foreign law debt, limited reliance on foreigners for local currency debt, and a large stock securities held by the BCB that pose negligible refinancing risks. Debt projections are highly sensitive to changes in interest rates given the high share of short-term and variable coupon debt.

Source: IMF staff estimates and projections.

Figure 4. Brazil: Baseline Scenario
(Percent of GDP unless indicated otherwise)

| | Actual | Medium-term projection | | | | | | | Extended projection | | | |
|---|--------|------------------------|------|------|------|------|------|------|---------------------|------|------|--|
| | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | |
| Public debt | 84.7 | 87.5 | 91.2 | 93.1 | 94.5 | 95.1 | 95.4 | 95.6 | 95.8 | 95.7 | 95.4 | |
| Change in public debt | 0.7 | 2.8 | 3.7 | 1.9 | 1.4 | 0.6 | 0.3 | 0.2 | 0.2 | -0.1 | -0.2 | |
| Contribution of identified flows | 2.6 | 2.4 | 3.7 | 1.9 | 1.3 | 0.6 | 0.3 | 0.2 | 0.2 | -0.1 | -0.2 | |
| Primary deficit | 2.4 | 0.6 | 0.7 | 0.4 | -0.1 | -0.6 | -1.0 | -1.2 | -1.3 | -1.4 | -1.5 | |
| Noninterest revenues | 35 | 37 | 37 | 37 | 37 | 37 | 38 | 38 | 38 | 37 | 37 | |
| Noninterest expenditures | 37 | 38 | 37 | 37 | 37 | 37 | 37 | 36 | 36 | 36 | 36 | |
| Automatic debt dynamics | 1.8 | 2.5 | 3.1 | 2.4 | 2.2 | 1.9 | 2.1 | 2.0 | 2.1 | 1.9 | 1.9 | |
| Real interest rate and relative inflation | 4.4 | 4.2 | 5.2 | 4.5 | 4.4 | 4.2 | 4.5 | 4.4 | 4.4 | 4.2 | 4.2 | |
| Real interest rate | 4.3 | 4.1 | 5.1 | 4.5 | 4.3 | 4.2 | 4.4 | 4.3 | 4.4 | 4.2 | 4.1 | |
| Relative inflation | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | |
| Real growth rate | -2.4 | -1.8 | -2.0 | -2.1 | -2.2 | -2.3 | -2.3 | -2.3 | -2.3 | -2.3 | -2.3 | |
| Real exchange rate | -0.2 | ... | ... | ... | ... | ... | ... | ... | ... | ... | ... | |
| Other identified flows 1/ | -1.7 | -0.7 | -0.1 | -1.0 | -0.8 | -0.8 | -0.8 | -0.6 | -0.6 | -0.6 | -0.6 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| (minus) Interest Revenues | -2.6 | -2.1 | -2.1 | -2.0 | -1.8 | -1.7 | -1.7 | -1.7 | -1.6 | -1.6 | -1.5 | |
| Other transactions | 0.9 | 1.4 | 2.0 | 1.0 | 1.0 | 1.0 | 0.9 | 1.0 | 1.0 | 1.0 | 1.0 | |
| Contribution of residual | -1.8 | 0.4 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | 0.0 | |
| Gross financing needs | 18.8 | 14.9 | 14.8 | 13.6 | 19.2 | 15.0 | 19.0 | 16.8 | 15.7 | 13.8 | 18.7 | |
| of which: debt service | 19.0 | 16.4 | 16.2 | 15.1 | 21.1 | 17.3 | 21.7 | 19.7 | 18.6 | 16.8 | 21.7 | |
| Local currency | 18.8 | 11.9 | 12.7 | 10.7 | 18.2 | 13.4 | 16.5 | 13.3 | 12.6 | 10.6 | 15.7 | |
| Foreign currency | n.a. | 0.5 | 0.7 | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 | 0.2 | 0.3 | |
| Memo: | | | | | | | | | | | | |
| Real GDP growth (percent) | 2.9 | 2.1 | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | |
| Inflation (GDP deflator; percent) | 4.7 | 5.0 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | |
| Nominal GDP growth (percent) | 7.7 | 7.2 | 6.0 | 5.9 | 6.0 | 6.1 | 6.1 | 6.1 | 6.1 | 6.1 | 6.1 | |
| Effective interest rate (percent) | 10.3 | 10.2 | 9.7 | 8.7 | 8.4 | 8.2 | 8.4 | 8.4 | 8.3 | 8.2 | 8.1 | |

Contribution to Change in Public Debt



Staff commentary: Public debt will rise over the medium term largely due to unfavorable r-g dynamics. Under staff's baseline, a fiscal consolidation of around 4 percent of GDP is expected to stabilize debt at around 95 percent of GDP, over the extended projection horizon.

Source: IMF staff estimates and projections.

1/ Negative values in the projections primarily reflect the use of interest rate revenues from the TSA account to finance debt.

Figure 5. Brazil: Medium-Term Risk Assessment

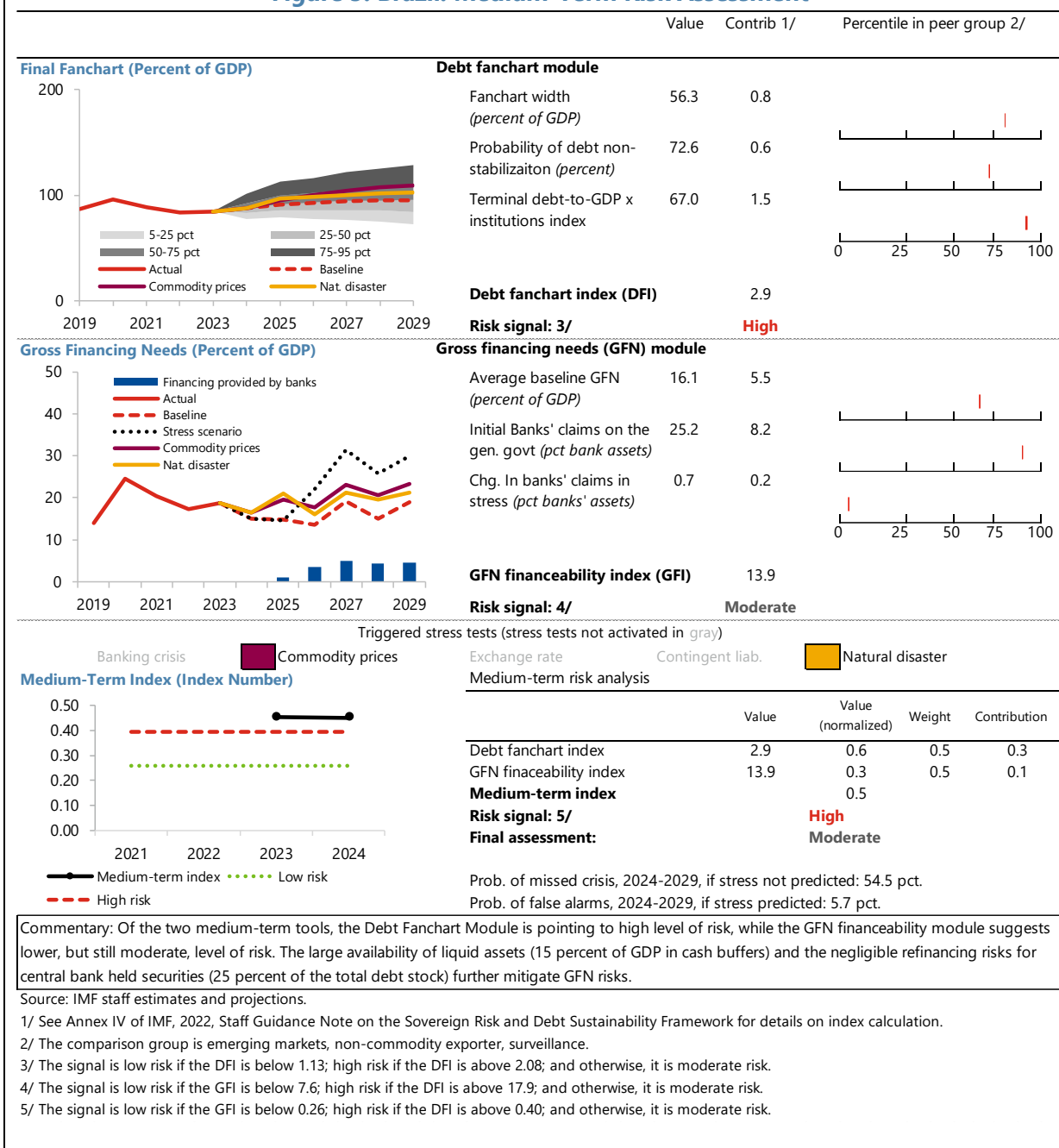
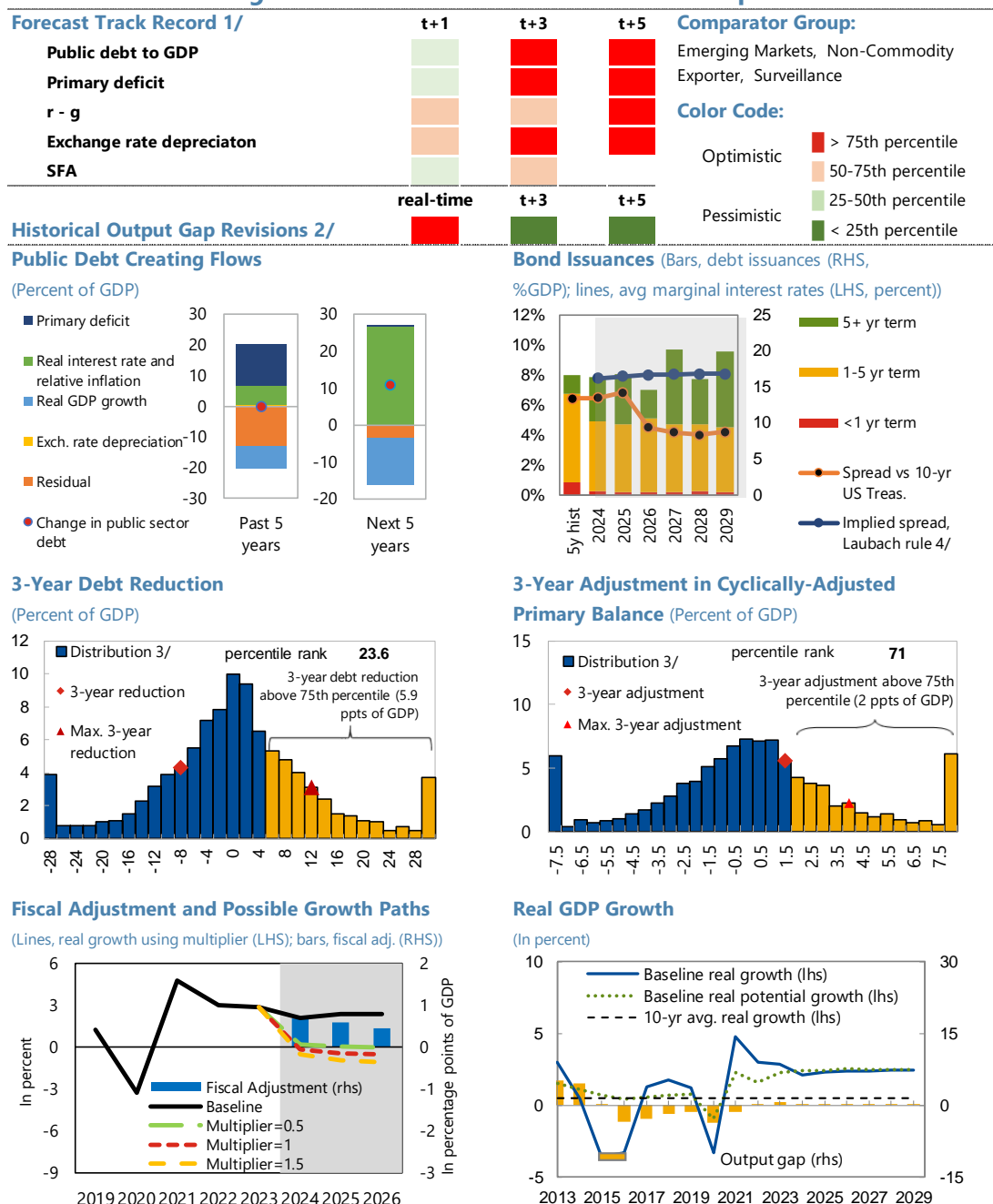


Figure 6. Brazil: Realism of Baseline Assumptions



Commentary: The composition of debt creating flows relies on significantly higher real interest rates compared to the lower rates prevailing during the pandemic. The 3-year adjustment in the cyclically primary balance is within historical norms.

Source : IMF staff estimates and projections.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates).

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

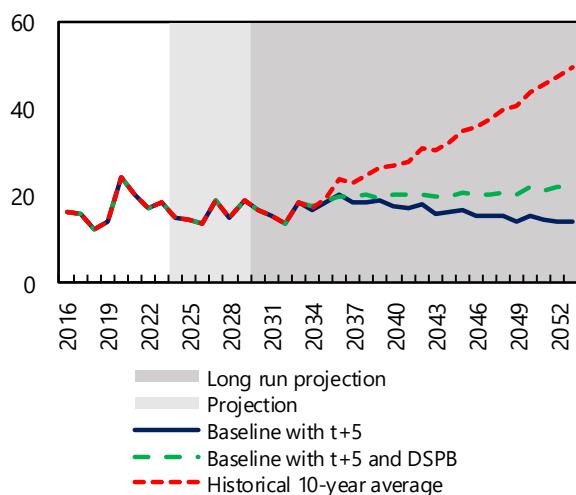
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 7. Brazil: Long-Term Risk Analysis

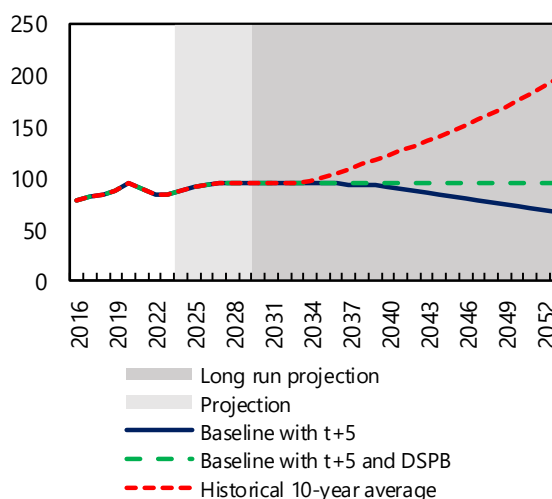
Brazil: Long-Term Risk Assessment: Large Amortization

| Projection | Variable | Risk Indication |
|---|---------------------------|-----------------|
| Medium-term extrapolation | GFN-to-GDP ratio | Green |
| | Amortization-to-GDP ratio | Green |
| | Amortization | Red |
| Medium-term extrapolation with debt stabilizing primary balance | GFN-to-GDP ratio | Green |
| | Amortization-to-GDP ratio | Green |
| | Amortization | Red |
| Historical average assumptions | GFN-to-GDP ratio | Red |
| | Amortization-to-GDP ratio | Red |
| | Amortization | Red |
| Overall Risk Indication | | Green |

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio



Commentary: Over the long-term, Brazil's rollover risk is moderate. In the event of abnormally large amortization, staff factored in the country's capabilities to engage in proactive debt management. Refinancing risks are mitigated by the overwhelmingly domestic investor base, large liquid assets held by the treasury and the substantial Central Bank holdings of federal securities that pose negligible refinancing risks. The historical scenario simulation might not be representative as it reflects historically elevated deficit, including the impact of the COVID-19 pandemic.

Source: IMF staff estimates and projections.

Annex VIII. Assessing Brazil's VAT Reform¹

1. After more than three decades in the making, Congress approved a landmark VAT reform in 2023. The reform addresses widespread inefficiencies emanating from the complexity and unique features of Brazil's current system of indirect taxation. It has the potential to be a game changer for Brazil's economy.

Raising Output and Productivity

2. Two general equilibrium models were used to examine the macro-distributional consequences of full crediting of taxes on intermediate goods. The first model is illustrative of a one-sector neoclassical open economy with intermediate goods and realistic (less than unit) substitutability between the capital-labor bundle and intermediate goods, carefully calibrated to the Brazilian economy. Reducing the tax on intermediate inputs to zero while imposing revenue neutrality via VAT adjustment, would increase GDP by 11 percent relative to the status quo in the long run. As other studies on the Brazilian tax reform,² this stylized result does not take into account the sectoral and rural-urban divide nor the informal sector, which accounts for roughly 20 percent of the Brazilian value added.

3. The second model takes into account several forms of heterogeneity in the production and household sectors. The IMF's Multisector Incomplete Markets Macro Inequality (MIMMI) App^{3,4} is customized to include taxation of intermediate transactions and other key characteristics of the Brazilian economy. It can match: (i) the input-output structure of the Brazilian economy, (ii) effective tax rates on intermediate and final purchases, (iii) the shares of value added and consumption expenditures in food, services and manufacturing, (iv) the share of informal output by sector, (v) the population in rural and urban areas; and (vii) the Gini coefficient and poverty rate, among other macro and distributional targets with remarkable precision.

4. In the MIMMI, the reform generates strong efficiency gains through an expansion of the formal sector, with only mild distributional and poverty rate implications. Full crediting of sales taxes on intermediate goods boosts GDP by 6 percent and rural and urban formality by 7 and 6 percent, respectively. Removing taxes on intermediates on (formal) manufacturing and services boosts the sectors' efficiency, lowers prices, and raises wages. Agricultural prices increase in relative terms. Poverty rates decline mildly in rural areas but increase somewhat (by less than 3 points) in

¹ This Annex was prepared by Alejandro Badel (SPR), Ana Cebreiro (FAD), Christina Kolerus (WHD), and Miguel Pecho (FAD).

² E.g., [Delalibera et al. 2024](#)

³ [Peralta-Alva et al. \(2023\)](#) and [Badel and Lyngaas \(2023\)](#).

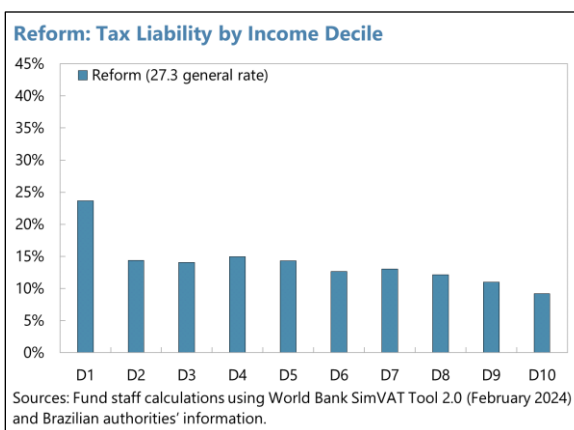
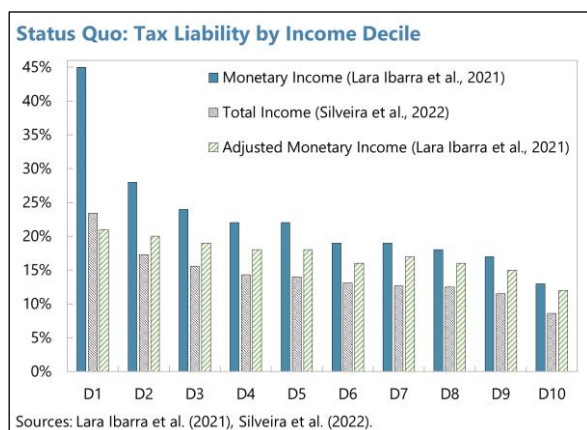
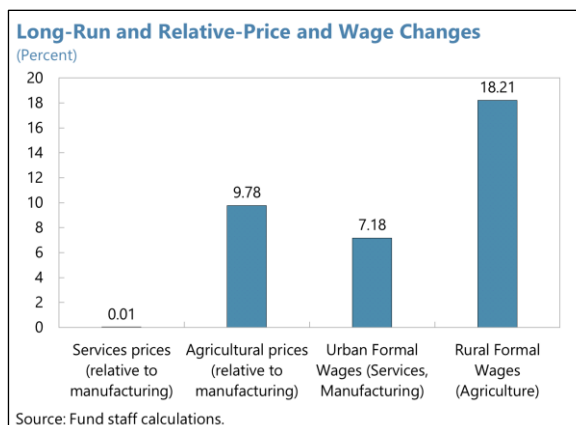
⁴ The MIMMI model features a large number of simulated, heterogeneous households that live in rural or urban areas. Households are employed in formal and informal work in the major production sectors (agriculture, services and manufacturing). Firms maximize in each sector profits under perfect competition and decreasing returns to scale with capital and labor acquired in regional markets and using intermediate inputs from all sectors. Supply and demand in goods and labor markets is in equilibrium via price adjustments.

urban areas, as informal urban producers face increased competition from a more efficient formal sector. To maintain revenue neutrality, the initial shortfall in tax revenues from full input tax crediting can be compensated by continued recalibration to increase and equalize VAT rates on services and manufacturing.

Improving Equity

5. The tax reform is expected to alleviate the tax burden on the poorest. The current

system of indirect taxation is substantially regressive, due to (i) high combined tax rates (estimated around 33.5 to 34.4 percent⁵); a biased taxation of goods relative to services; and numerous concessions that disproportionately benefit middle- and upper-income households. A range of studies show that households in the poorest decile of the income distribution face a consumption tax liability of 20–45 percent of their monetary income, compared with 10 percent for the richest decile.⁶ The reform aims to address distributional concerns by introducing a cashback system for the poorest, which would reimburse 20 percent of VAT paid, as well as exemptions and reduced rates on products relatively more consumed by lower-income households. Moreover, the standard VAT rate would be capped at 27.3 percent, significantly below most of the current combined rates. Simulating the distributional impact under the proposed design with the World Bank SimVAT Tool, staff estimates a smoother distribution of the tax liability across household income deciles, mainly due to a reduction in the lower income deciles.⁷ Nevertheless, the tax burden on the poorest decile would remain about twice as high as the burden on the richest decile. This can be largely explained by the



⁵ [Treasury](#) and Receita Federal do Brasil (RFB) estimates.

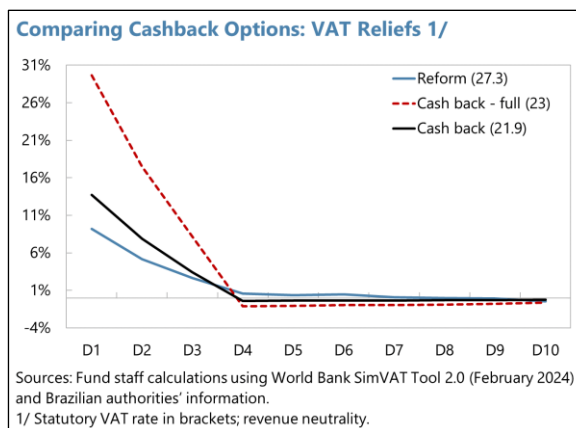
⁶ The estimated distributional tax burden varies with the definition of income, i.e. whether monetary income is adjusted to match monetary consumption when the latter is higher, and the coverage of household surveys. Given data limitations, some studies use the state of São Paulo ([Lara Ibarra et al. 2021](#)) as a representative state, while others incorporate less urban areas ([Silveira 2012](#)).

⁷ A modest impact on equity is also found by [Siqueira et al. \(2024\)](#), [Orair and Gobetti \(2019\)](#) and [Lara Ibarra et al. \(2021\)](#), [Vale et al. \(2023\)](#).

continuation of exemptions and reduced rates, including for education and health, which cushion the tax impact on higher income households.

6. The new VAT could further boost equity by better targeting the poor through an expanded cashback system. The burden on the most vulnerable could be eased with an expansion of the cashback system (while limiting other concessions). Four possible scenarios are considered:⁸

- **Reform:** *Cesta Básica's* food and medicines, urban transport, and books are exempt; a reduced rate (40 percent of the standard rate) is levied on non-urban transport, fruits and vegetables, *Cesta Básica's* goods for personal hygiene, health, education, culture and sport; households in *Cadastro Único* receive a refund of the VAT paid.⁹
- **Cash Back:** A single VAT standard rate applies to all goods and services; households in the *Cadastro Único* receive a refund of the VAT paid on goods and services in *Cesta Básica*, water and sewage, cooking gas and fuels, energy, education and health.
- **Cash Back (full):** A single VAT standard rate applies to all goods and services; households in the *Cadastro Único* receive a refund of all VAT paid.



The maximum benefit for the poor would be achieved under a full cashback transfer (turning the VAT into a progressive tax), while allowing for a lower and single VAT statutory rate. Depending on the design of the cashback transfers, the system could have other significant advantages, for instance in terms of compliance incentives, in particular if the compensation can be done in real-time¹⁰ and with e-invoicing already in place.

Integrating Governance and Harmonizing Operations

7. Efficient governance of the dual VAT requires an integrated managing body for both CBS and IBS. The reform aims at a single approach for managing CBS-IBS across all levels of governments anchored on unified legislation, harmonization of tax procedures, digitalization, and

⁸ Refund amounts to 30 percent on water, sewage and energy, 47 percent on cooking gas and fuels, and 20 percent on other goods and services. Revenue collection is held constant, and an excise tax is levied on wine and beer (20 percent), other alcoholic drinks (35 percent), fuel for vehicles (15 percent), and tobacco (250 percent), with no cashback or tax crediting applied to these products.

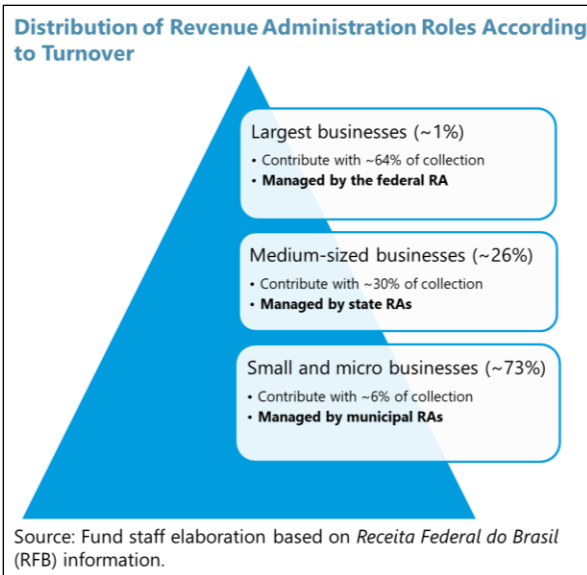
⁹ Assuming split into 32 percent for CBS and 67 percent for IBS, and based on 100 percent cash back on cooking gas and fuels for CBS and 20 percent for IBS, and 50 percent and 20 percent on water, sewage and energy for CBS and IBS respectively.

¹⁰ [De la Feria and Swistak \(2024\)](#)

exchange of information. The new management council (*Comitê Gestor*) overseeing CBS will be responsible for unified legislative interpretation, managing collection and revenue sharing arrangements, resolving administrative reviews, and overseeing reviews and audits. However, there is no similar council for integrating the management of CBS and IBS, as for instance in India. The reform foresees a more integrated work between the federal and state/municipal governments (as also the case for managing SIMPLES), but governance framework is still to be defined.

8. Achieving complete and timely crediting of input VAT will minimize uncertainty during the transition period and unlock reform benefits early on. Locking in an irreversible path towards full implementation is key to build credibility and lower uncertainty during the transition. A key feature is the full crediting of taxes paid on inputs purchased domestically or abroad. The reform foresees to refund excess credits promptly and without first carrying them forward, in line with good practice. However, the proposed timeframe of 60 days (270 for special cases) should be brought in line with international good practice of 30 calendar days. In addition, the split payment mechanism should be introduced with caution to avoid turning the VAT into a cash-based tax.

9. Leveraging synergies across all levels of government is essential to boost compliance and efficiency. The high degree of autonomy of each state and heterogeneous capacity across municipalities pose significant challenges for harmonizing operations and approaches for compliance. Technology could play an important role for centralizing certain functions or managing them through regional centers of excellence. In addition, a clear understanding by each revenue administration is required as to what its role is in operating the dual VAT, agreed in a well-defined regulation or MOU. Segmentation could help revenue administrations in finding a balanced distribution of roles and a taxpayer's size is the most common criteria for grouping them.



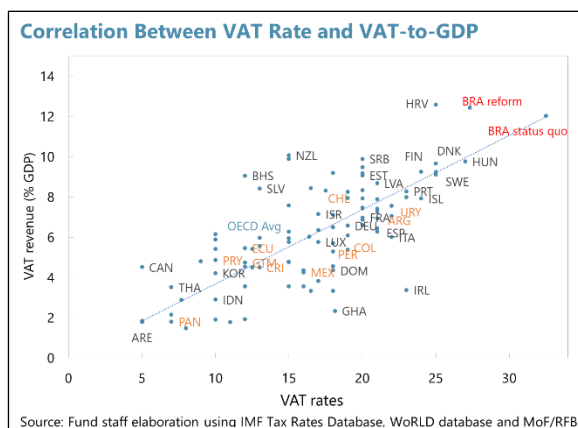
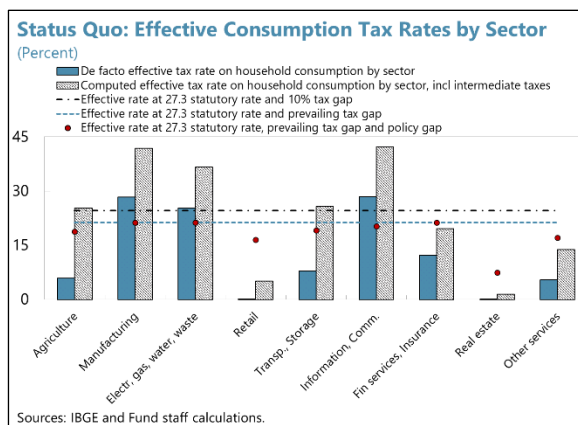
Ensuring Revenue Neutrality

10. Potential risks to revenue neutrality stem from fundamental shifts in revenue bases, compliance and policy gaps, and informality. Benefits from changes in relative prices and price adjustments will take time to materialize, while the downward adjustment in some rates will be immediate. Compliance and policy gaps will need to narrow significantly to reach the targeted revenues, outperforming OECD countries.

- **Shift from Producer to Consumer Tax Base.** Full crediting of intermediate inputs will shift the tax liability from producers to final consumers. While this is a common feature in VAT reforms, it is an especially large reallocation in Brazil, with around 4½ percent of GDP collected on

intermediate inputs. In addition, there is considerable uncertainty about how quickly firms will pass on lower prices to consumers.

- Shift across Sectoral Tax Bases.** The reform sets the reference rate for CBS-IBS, which functions as an upper bound on VAT rates. This implies lower statutory rates for manufacturing; information and communications; and electricity, gas water, and waste. Revenue losses would need to be compensated by higher statutory rates for agriculture and retail (sectors with higher informality) and services in general (typically associated with higher avoidance).
- Compliance Gap.** The estimated tax gap of 22.3 percent on PIS/COFINS¹¹ is relatively high compared to peers, yet commensurate to Brazil's current tax rate and collection.¹² While the reform is expected to boost compliance through harmonization and lower complexity, a shift to services typically implies a larger compliance gap.
- Policy Gap.** A wide range of reduced rates, exemptions, and special regimes have already been granted, with the reference rate close to the maximum. The continuation of the SIMPLES special tax regime further adds uncertainty.
- Informality.** Building on the literature and in line with the model specifications, staff estimates that revenue gaps of around 1–2 percent of GDP could arise due to informality.

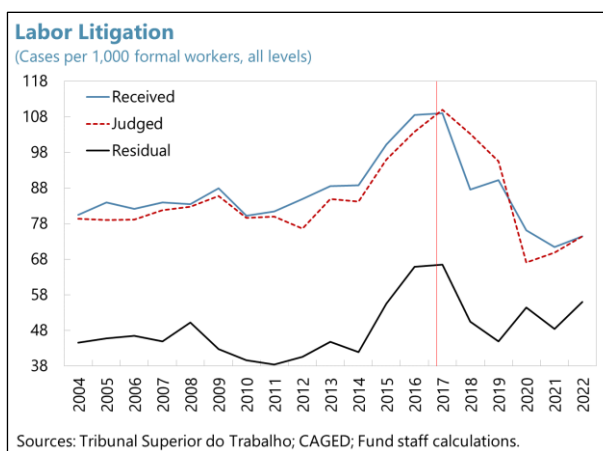


¹¹ [Receita Federal 2020](#)

¹² Brazil's revenue collection from goods and services includes taxes on fuels that are typically collected as excises in other countries, and might therefore bias the revenue to GDP ratio upwards (0.3–0.6 percent of GDP).

Annex IX. The Impact of Labor Litigation Cases on Firm-Level Productivity¹

1. Labor litigation cases dropped markedly in Brazil since 2017. The Brazilian Labor Law went through significant changes in 2017 with reforms to reduce litigation and increase flexibility in employment contracts and wage setting (IMF 2017 and 2018 Staff Reports). The reforms made important changes to discourage excessive litigation through tightening standards for: (i) different fees—e.g., proof of income required to be exempted from court fees; (ii) frivolous and groundless litigation (plaintiffs can be required to pay a fine and/or compensate the defendant); (iii) withdrawal of complaints (if the opposing side has presented the defense, the plaintiff is required to get the consent from the opposing side); and (iv) complaint requirements, following similar guidelines to those of civil complaints.² These changes were significant from the employers' perspective. For example, 7.4 percent of 1,802 Brazilian firms in the 2009 [World Bank Enterprise Survey](#) had reported labor regulations as the biggest obstacle, almost double of those reported for all countries and Latin America and Caribbean across all the years surveyed (3.9 percent and 3.6 percent, respectively).



2. Staff analysis combined three data sources on firm-level productivity, employment, and litigation cases to estimate the impact of the decline of litigation costs on firm-level productivity. The analysis uses over 4,500 private and public firms from 2014 onwards from the Bureau van Dijk's (BvD) Orbis global database, comprising different industries. BvD collects data from various sources and harmonizes them into an internationally comparable format. It also provides data on the location of the firms' headquarters; in the case of Brazil, corresponding to the state. This dataset is combined with state-level data from (i) the PNAD survey on labor force and employment, and (ii) TST (*Tribunal Superior do Trabalho*) on number of labor litigations by state.

3. The empirical strategy exploits state-level variation in litigation cases. Following the methodology proposed by Akerberg and others (2015), TFP is estimated using a gross output approach, with cost of goods sold and tangible fixed assets as inputs. A measure of state-level exposure to the labor reform is constructed from the number of labor disputes as a share of both the state's labor force and employment. To understand whether the reform had a differential impact for labor- and trade-intensive firms, labor and trade intensity across firms is computed using data

¹ This Annex was prepared by Samuel Pienknagura (RES) and Swarnali Hannan (WHD), with excellent research assistance and suggestions from Gabriel Moura (WHD).

² For details on the changes, see Corbi, Ferreira, Narita, and Souza (2022).

for firms in advanced economies.³ A sector's labor intensity is constructed by calculating the median ratio of labor cost over total costs for firms in the sector in key advanced economies. Similarly, a sector-level measure of trade intensity is constructed by computing the median ratio of export revenue over sales for each sector. The regression specification is as follows:

$$tfp_{i,s,t,k} = \beta * post * intensity * \Delta litigation + \gamma_{k,t} + \sigma_{s,t} + \theta_i + \vartheta X_{i,t} + \varepsilon_{i,k,t,s}$$

where *post* is a dummy variable taking value one if the year is post 2017; $\gamma_{k,t}$, $\sigma_{s,t}$, and θ_i are sector-time, state-time, and firm fixed effects; $X_{i,t}$ are firm-level variables (lagged TFP); *intensity* captures either labor or trade intensity. $\Delta litigation$ captures the change in state-level litigation as a share of employment between 2016 and 2019. The parameter of interest, β , captures the difference in productivity between the firms most affected by the reform (those in labor/trade intensive sectors, in states with large changes in litigation cases) versus other firms.

4. The analysis shows a significant boost in TFP for labor- and trade-intensive firms from the decline in litigation costs. The regression estimates imply that firms in the average state in labor intensive sectors (90th percentile of the sectoral distribution) witnessed an increase in TFP of about 15 percent after the 2017 reform due to the decline in litigation cases, compared to firms in low labor-intensive sectors (10th percentile). High trade-intensive firms witnessed a similar increase in TFP after the reform compared to firms in low trade-intensive sectors. All these effects are statistically significant. The estimates report the differential impact of the fall in litigation *across firms*, depending upon their labor and trade intensity. This would roughly translate into an *aggregate* productivity increase of 5 percent—the estimated impact of the fall in litigation on the productivity of firms in a sector with average labor intensity is compared to a counterfactual scenario where litigation did not change. The findings are in line with Corbi and others (2022) who find that the reform had significant positive effects on employment and aggregate output by reducing incentives to litigate and expected costs of lawsuits.

5. The results hold after several robustness checks. One caveat is that Orbis reports the state where firm is headquartered, whereas labor employment and litigation data are based on the state where the firm is located. However, this issue may be less relevant for Brazil since around two thirds of active companies in Brazil are individual entrepreneurs, and thus the headquarter and location are likely to be the same state. Nevertheless, various robustness checks are performed, including removing from the analysis top-sized firms and large states (Brasília, Rio de Janeiro, and São Paulo) where the likelihood of different states for location and headquarter could be higher. The results are robust to all these specifications. An additional robustness check is performed by employing the level of pre-reform litigation cases (rather than the change in the number of litigation cases) to capture the differential impact on high- versus low-exposure litigation states. High labor- and trade-intensive firms in high-exposed litigation states are found to have an increase in TFP following the reform.

³ The analysis used firm-level data for Belgium, Denmark, Finland, France, Greece, Italy, the Netherlands, Norway, Portugal, Spain, and the United Kingdom.

Annex X. Past IMF Recommendations and Implementation Status¹

| <i>Past IMF Recommendations</i> | <i>Implementation Status</i> |
|--|---|
| Fiscal Policy | |
| Implement more ambitious fiscal effort that continues beyond 2026, anchored in an enhanced fiscal framework that builds on the new rule. | The 2024 Draft Budget Guidelines Law submitted to Congress in April proposes a zero federal primary deficit target for 2025 with a narrow tolerance band, and targets for increase in subsequent years to a federal primary surplus of 1.0 percent of GDP in 2028. |
| Pursue expenditure reforms to tackle spending rigidities. | The authorities are undertaking spending reviews of pension and social program. |
| Advance planned revenue-neutral indirect tax reform that streamlines tax regime and reduces the cost of tax compliance. | The implementation of the 2023 VAT reform is advancing with four complementary laws under preparation. |
| Monetary and Exchange Rate Policies 1/ | |
| Ensure that monetary policy action and communication strengthen credibility around the recently adopted continuous inflation target. | The pace of monetary easing has been appropriately cautious. After 50 basis point rate cuts for six meetings, the central bank reduced rates by 25 basis points to 10.5 percent in May and kept rates unchanged in June. |
| Financial Sector Policy | |
| Supplement the planned measures to facilitate household debt restructuring with targeted prudential limits. | The BCB closely monitors household credit risks and issued warnings in early 2023 which helped persuade private banks to tighten lending standards on credit cards. The BCB has the legal mandate to implement new macroprudential limits when needed. |
| Structural and Climate Policies | |
| Pursue supply-side reforms to boost potential growth, including tackling spending rigidities to make room for public investment. | The authorities envisage increasing public investment, while preserving debt sustainability, as part of the Growth Acceleration Plan. |
| Pursue policies to protect economic activity, assets, and livelihoods, including boosting the Amazon's resilience to climate shocks via fiscal incentives for forest protection, investing in climate smart agriculture and insurance, continuing diversification of power supply to renewables, developing a green and social taxonomy, and leveraging the BCB Sustainability Agenda. | Deforestation in the Amazon was cut by half in 2023. The government is committed to halting illegal deforestation by 2030. Important progress has been made on establishing Brazil's Sustainable Taxonomy. The ETS was approved by the Lower House and is now being considered by the Senate. The Forest Law was approved in 2023, enabling carbon credits and other environmental services in conservation areas. Brazil's first Global ESG sustainable government bond was issued in November 2023. |
| 1/ See Annex XI for an update on implementation of the 2018 FSAP recommendations. | |

¹ This Annex was prepared by Bunyada (Mos) Laoprapassorn (WHD).

Annex XI. Implementation of Key FSAP Recommendations¹

| Recommendations | Time | Authorities' Actions |
|--|------|--|
| Microprudential and Macprudential Institutional Arrangements | | |
| Establish a multi-agency high-level committee, with an explicit mandate for macroprudential policy and the power to issue policy recommendations on a comply-or-explain basis. | ST | The BCB, CVM, Previc and SUSEP finalized the "Financial Stability Coordination Law", a draft bill which is now being discussed with the Ministry of Finance. |
| Strengthen the crisis management institutional arrangements for inter-agency cooperation and exchange of information, including for contingency planning. | MT | The "Financial Stability Coordination Law" draft bill proposes the creation of a "Financial Stability National Committee" that would have authority over macroprudential policy and crisis management (including contingency plans/crisis management). The BCB's contingency planning has already been implemented. |
| Strengthen legal protection of all supervisors (BCB, SUSEP) through clear rules, including fixed term, condition of dismissal, public disclosure of reasons for dismissal and qualification criteria for appointments. Strengthen the independence of the BCB. | ST | <p>In 2021, Complementary Law 179 of 2021 was enacted, establishing the objectives of the BCB, its autonomy and the procedures to appoint and remove Board members. The law defines price stability as the primary objective of the BCB and sets four-year terms (with one possible renewal) for Board members. Most Board member terms do not coincide with the presidential term. The law also establishes the cases in which the removal of Board members is admissible (proven and recurring underperformance, with approval by an absolute majority of the Senate).</p> <p>The law also provides for aspects of operational autonomy, delegation of decisions about other monetary policy and macroprudential tools from CMN to BCB, and enhances policy transparency, such as through the publication of inflation and financial stability reports. However, it does not establish legal protection for BCB's staff. Neither does it grant effective financial and administrative independence to the BCB.</p> <p>The Bank Resolution bill – submitted to the lower house and currently being discussed by a special congressional committee – provides for protection of public agents. As it stands, this bill includes both a provision for legal protection and for legal defense by the General Counsel, to be covered by the BCB.</p> <p>There is a proposal of Constitutional Amendment (PEC 65/2023), which is devoted to establishing the financial and administrative independence to the BCB. The bill rapporteur is the senator Plínio Valerio (PSDB-AM). Decree nº 9.727/2019 and Decree nº 10.829/2021 have established qualification criteria for appointments to strategic positions in the Administration, including supervisory institutions. SUSEP has drafted a bill to merge with the pension funds supervisor (Previc), addressing, among other issues, the structure and responsibilities of the new authority.</p> |

¹ The description of authorities' actions in this table is based on information provided by the Brazilian authorities. ST refers to "short-term" and MT refers to "medium-term".

| Recommendations | Time | Authorities' Actions |
|--|------|---|
| Increase resources of CVM and SUSEP. | ST | Both CVM and SUSEP are subject to budget constraints, given Brazil's fiscal situation and a freeze in public wages over the past years. |
| Systemic Risks | | |
| Use Pillar 2 capital requirements to handle bank-specific risk profiles to boost their resilience as needed and to mitigate risks. | ST | Structured and by Reference Add-ons are implemented in the BCB's supervisory methodology. The Structured Add-on is fully implemented (segments from S1 to S4). The Add-on by Reference is applied to financial institutions allocated to Segments S1 and S2 and includes metrics for credit concentration risk and Interest Rate Risk of Banking Book (IRRBB). Financial institutions identified as having an exposure not adequately considered in Pillar 1 capital requirements – according to BCB's estimates – in one of these two approaches have reported add-on regularly to the BCB. |
| Financial Sector Oversight | | |
| Upgrade the banking sector's regulatory and supervisory approach to credit risk— including identification and definitions, limits, and reporting requirements—for related party exposures and transactions, large exposures, country and transfer risk and restructured loans. | MT | <p>The following actions have been completed:</p> <p>(i) CMN has issued Resolution 4,677/2018 (Basel III reform on Large Exposure Limits), establishing limits and report requirements for single client and large exposures. Rules have been applied for Prudential Segments S1 and S2 since January 2019 and for Segments S3, S4 and S5 since January 2020. The Report on Operational Limits—DLO (Circular Letter 3,926) includes information on large exposure limits.</p> <p>(ii) The CMN issued Resolution 4.693/2018 addressing credit operations between related parties. Accordingly, accounting items were created as of January 2019 to collect information from Related Parties, in which financial institutions report the greatest exposure (natural person and legal entity) and other exposures with related parties. A field is also included in the SCR to inform whether the contracted operation is being carried out with related parties.</p> <p>(iii) The CMN amended regulation on risk management (Resolution 4.557/2017) to include section establishing specific requirements for country and transfer risks, with specific treatment of indirect risks.</p> <p>Other initiatives under analysis or being drafted include:</p> <p>(i) Regulation on prudential treatment of transactions with related parties.</p> <p>(ii) Requirement of producing concentration risks data on a regular basis.</p> <p>(iii) Structured assessment of country, transfer and indirect risk.</p> <p>(iv) IFRS9 regulation is already published and implementation is scheduled for January 2025. It will enhance the credit risk framework definitions, including the definition of credit risk exposure and problem assets.</p> |

| Recommendations | Time | Authorities' Actions |
|--|-----------|---|
| Strengthen enforcement function of CVM by raising the level of sanctions and ensuring adequate resources for prosecution; strengthen cooperation allowing CVM proper oversight of ANBIMA's SRO activities in the investment fund sector. | ST | The expansion of the scope of the agreement with ANBIMA is ongoing, to include the subject of supervision of mandate (portfolio breaches). Funds ruled by CVM instruction 555 (which represent more than 85% of the industry) are included. An extended version of this agreement was adopted in 2021. CVM Instruction 607 of July 2019 was issued to establish procedures related to the Law 13.506/17 that expanded CVM's enforcement power. |
| Implement (BCB, ANS and SUSEP) consistent group-wide supervision of insurance groups and conglomerates with joint rulemaking, implementation, and on-site inspections and granular data sharing. | MT | The authorities' efforts in this area are ongoing. The granular data sharing depends on legal provisions and on the establishment of partnerships among the supervisors. The creation of the "Financial Stability National Committee" would partially bridge this gap. |
| Crisis Management and Bank Resolution, Safety Nets | | |
| Revise the draft resolution law in line with the FSAP team's recommendations and promptly enact it. | ST | The draft bill was submitted to Congress in December 2019. The Bill of Law 281 of 2019 is pending appreciation by the Lower Chamber. |
| Revise the ELA framework to provide for a solvency test tied to enhanced supervision, remedial plans, and possibly restructuring measures, and allow for ELA in systemic circumstances upon a MoF indemnity. | ST | The BCB reaffirms its point on this recommendation. While solvency analysis is important for ELA assessment, the BCB does not agree that being solvent on a point-in-time basis should be the main determinant of ELA approval, as it may bind ELA approval and lead to high moral hazard. The systemic impact of a negative response to an ELA request is also relevant, so the BCB prefers to retain the flexibility to decide, with its discretionary power. The recommendation of indemnity of the MoF in case of ELA in systemic circumstance will not be implemented since it may increase moral hazard risk and the BCB balance sheet is part of the government accounts (which means the National Treasury will have to indemnify the BCB anyway, in case of BCB balance sheet loss). The BCB deployed Temporary Liquidity Facilities (ELA for the COVID-19 crisis) in April 2020. New permanent liquidity facilities were implemented in November 2021, as planned. Broadening the collateral framework to include new facilities is ongoing, with the acceptance of CCB (securitized individual bank loans) expected by 2024Q3. |
| Put in place mechanisms to ensure lending from the deposit insurance fund is not used to maintain weak or insolvent banks in operation; and transform FGC into a fully owned public institution. | ST; MT | The FGC has already amended its by-laws to establish communication to the BCB prior to each assistance operation. The BCB has signed a MoU with the FGC to grant access to detailed information on financial institutions that are FGC members. The Administration Committee of the MoU was set as a permanent forum for information sharing and collaboration between the parties to facilitate FGC assessment and avoid the use of lending to maintain weak or insolvent banks in operation. The recommendation to transform the FGC into a fully public-owned institution will not be implemented. |

| Recommendations | Time | Authorities' Actions |
|--|------|---|
| Financial Integrity | | |
| Complete the national AML/CFT risk assessment and introduce a risk-based approach specific to AML/CFT supervision. | ST | The coordination of the activities related to the National AML/CFT Risk Assessment is attributed to the Brazilian Intelligence Unit (Coaf). The decree to establish the Strategic Committee for the National AML/CFT Risk Assessment was issued in March 2020. The risk assessment was completed and published in 2021. |
| Financial Intermediation Efficiency | | |
| Foster competition through client mobility and financial product cost transparency and comparability. | ST | <p>The CMN issued Resolution 4,639/2018 to make it easier for customers to exert their right to have their compensation deposited in the institution of their preference. Specifically, it allowed salaries being transferred to payment accounts besides deposit accounts (creating a levelled playing field for banks and payment institutions); and it allowed costumers to request their salary's portability directly to their preferred institution, avoiding frictions and embarrassments when customers decide to transfer their salary to a different institution.</p> <p>Resolution CMN 4,639/2018 has been consolidated by Resolution CMN 5,058/2022, which maintained the salary's portability rules. The Credit Registry Law, in effect since 2011, was amended by Complementary Law 166/2019, and regulated by Resolution 4,737/2019, to adopt an opt-out instead of an opt-in model.</p> <p>Resolution 4,734/2019 and Circular 3,952/2019 set rules for registering and blocking credit and debit card receivables pledged as collateral in credit operations. With these measures, the volume of blocked receivables cannot exceed the outstanding balance of the transaction, which precludes a previous practice of totally blocking the receivables. Moreover, it allows retailers to discount their receivables at any financial or accrediting institution of their choice.</p> <p>In 2022, the regulation on credit portability were revised and consolidated under the Resolution 5,057/2022, issued by the CMN in December. The consolidation aimed mainly at simplifying and unifying the different normative acts, with some clarifications made to foster the portability of credit operations by legal entities.</p> <p>The set of credit modalities eligible for portability between financial institutions was expanded in 2019 by Resolution CMN 4,762/2019, which included credit granted to individual microentrepreneurs and to legal entities. Additionally, different credit modalities were included in the list of credit portability, providing a larger menu of options to customers.</p> <p>Moreover, the implementation of Open Finance in Brazil, mainly regulated by Joint Resolution CMN-BCB No. 1/2020 and observing the General Data Protection Law (No. 13,709/2018), has the potential to help client mobility and improve cost transparency and comparability. Pix, the Brazilian instant payment system, is an innovation under open finance and has helped reduce transaction cost and encourage competition.</p> |

| Recommendations | Time | Authorities' Actions |
|--|------|---|
| Reform of Public Banks | | |
| Change product offering of BNDES under new strategy with focus on catalyzing private sector finance and developing the financial sector. | ST | <p>In January 2023, a new administration took office in BNDES with an agenda to revitalize the industry sector and promote an inclusive, green, digital, innovative, and creative economy. BNDES wants the private sector to be its partner on this agenda, gathering strengths to induce sustainable development.</p> <p>Since then, BNDES is making efforts to enlarge and develop market-based financial instruments to promote long term development. This initiative includes fostering domestic credit and capital markets, and improving access to international funding. The Bank is also seeking to improve lending operations through partnerships with multilateral development institutions.</p> <p>The BNDES strategic plan envisages the reduction of risks on infrastructure investment, which will help catalyze private sector finance. The environmental agenda embraces the climate agenda, including raising green funds and fostering the decarbonization of the economy. Among the initiatives on social inclusion, BNDES wants to promote credit cooperatives and intensify its support through microcredit. The Bank also intends to design better financial solutions dedicated to SME's, including through capital markets.</p> |
| Focus Caixa on core activities, improve governance, and invite a strategic investor. | | <p>CAIXA continues to reposition its credit operations by prioritizing loans to micro companies, payroll-deducted loans and loans to the housing sector, strengthening its operations in the "Minha Casa Minha Vida" program.</p> <p>CAIXA also continues to improve its corporate governance practices, in line with principles such as transparency, equal treatment, inclusion, accountability, corporate social responsibility, and sustainability. Gender diversity is a priority, and CAIXA is the first major Brazilian bank to have more female than male Board members.</p> <p>Through its subsidiaries, Caixa has since 2019 entered several strategic partnerships in insurance and card segments. In parallel, Caixa's insurance holding company (Caixa Seguridade Participações S/A) raised capital through an IPO in April 2021.</p> <p>CAIXA's investment banking group was strengthened with the internal reallocation of professionals, aiming at expanding the Bank's pre-existing fixed income capital markets' operation and create a complete structure of investment bank products. CAIXAPAR, a subsidiary of CAIXA, sold all its shares in Banco Pan to BTG Pactual in 2021.</p> |



BRAZIL

June 20, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

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FUND RELATIONS

(As of May 9, 2024)

Membership Status: Joined January 14, 1946; Article VIII

General Resources Account:

| | SDR Million | Percent Quota |
|---|-------------|---------------|
| Quota | 11,042.00 | 100.00 |
| Fund Holdings of Currency (Exchange Rate) | 8,286.00 | 75.04 |
| Reserve Tranche Position | 2,765.70 | 25.05 |
| Lending to the Fund | | |
| New Arrangement to Borrow | 0.00 | |
| | | |

SDR Department:

| | SDR Million | Percent of Allocation |
|---------------------------|-------------|-----------------------|
| Net Cumulative Allocation | 13,470.34 | 100.00 |
| Holdings | 14,204.81 | 104.45 |

Outstanding Purchases and Loans: None

Financial Arrangements:

| Type | Date of Arrangement | Expiration Date | Amount Approved | Amount Drawn |
|----------------------|---------------------|-----------------|-----------------|--------------|
| | | | (SDR Million) | |
| Stand-by | 09/06/2002 | 03/31/2005 | 27,375.12 | 17,199.64 |
| <i>Of which:</i> SRF | 09/06/2002 | 09/05/2003 | 7,609.69 | 7,609.69 |
| Stand-by | 09/14/2001 | 09/05/2002 | 12,144.40 | 11,385.37 |
| <i>Of which:</i> SRF | 09/14/2001 | 09/05/2002 | 9,950.87 | 9,950.87 |
| Stand-by | 12/02/1998 | 09/14/2001 | 13,024.80 | 9,470.75 |
| <i>Of which:</i> SRF | 12/02/1998 | 12/01/1999 | 9,117.36 | 6,512.40 |

Projected Payments to the Fund (SDR million; based on existing use of resources and present holdings of SDRs):

| | Forthcoming | | | | |
|------------------|-------------|-------------|-------------|-------------|-------------|
| | 2024 | 2025 | 2026 | 2027 | 2028 |
| Principal | | 0.00 | 0.00 | 0.00 | 0.00 |
| Charges/Interest | | 0.10 | 0.10 | 0.10 | 0.10 |
| Total | | 0.10 | 0.10 | 0.10 | 0.10 |

Safeguards Assessments: A safeguards assessment of the Banco Central do Brasil (BCB) was completed in June 2002 and updated in March 2005.

Exchange Rate Arrangement: Since January 18, 1999, Brazil's de facto and de jure foreign exchange regime has been classified as floating. Brazil accepted the obligations of Article VIII, Sections 2(a), 3, and 4, effective November 30, 1999.

Brazil maintains a multiple currency practice (MCP), which is also an exchange restriction (subject to Fund jurisdiction under Article VIII, Sections 2(a) and 3), under the Fund's MCP policy which became effective on February 1, 2024.¹ This MCP and exchange restriction arises from the longstanding tax on financial transactions (*Imposto sobre Operações Financeiras*, IOF), currently of 4.38 percent on exchange transactions carried out through credit card, debit card, and traveler's checks (including cash withdrawals) by companies in order to fulfill their payment obligations for purchases of goods and services abroad by their customers.² In March 2022, Brazil's Executive Branch published Presidential Decree 10.997/2022 that will gradually reduce the IOF-FX rates on all eligible FX settlements to 0 percent by 2029.

Last Article IV Consultation

The last Article IV consultation with Brazil was concluded by the Executive Board on July 31, 2023. The Financial Sector Assessment Program (FSAP) took place in 2002 and was updated in 2012 and 2018.

Capacity Development

The Statistics Department provided remote technical assistance on nonfinancial public sector Government Finance Statistics (GFS) data compilation in November 2020 and on Balance of Payments and International Investment Position issues in February 2021. The Monetary and Capital Markets Department has provided technical assistance on debt management issues.

¹ The effective exchange rate of exchange transactions subject to the IOF-FX exceeds the permissible margin from February 1, 2024, under the Fund's new MCP policy.

² Brazil previously maintained an MCP, which was also an exchange restriction, arising from the same official action (please see Informational Annex to the Country Report No. 23/288). In line with the new MCP policy that became effective on February 1, 2024, all MCPs maintained by members under the previous MCP policy are considered eliminated as of February 1, 2024. The following MCPs are considered eliminated as of July 1, 2022: MCPs arising from (i) FX auction if the auction meets the criteria set out in Paragraph 15, (ii) official exchange rate if its calculation conforms to the conditions specified in Paragraph 16 and (iii) illegal parallel markets as specified in Paragraph 17 of the ["Review of the Fund's Policy on Multiple Currency Practices—Proposals for Reforms"](#) (2022).

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank: <http://www.worldbank.org/en/country/brazil>

Inter-American Development Bank: <https://www.iadb.org/en/who-we-are/country-offices/brazil>

New Development Bank: <https://www.ndb.int/>

Statement by Afonso Bevilaqua, Executive Director for Brazil
July 8, 2024

On behalf of my Brazilian authorities, I thank Mr. Leigh and his team, as well as the outgoing mission chief and now senior reviewer, Ms. Corbacho, for the candid and fruitful engagement under the 2024 Article IV consultation. The authorities appreciated the intense policy dialogue, and their views are broadly convergent with those of staff.

Growth Continues to Surprise on the Upside

Brazil's economic performance in 2023 was marked by strong growth amid falling inflation. GDP grew 2.9 percent, well above market and Fund expectations of 0.8 and 1.2 percent growth, respectively, at the beginning of the year. As a result, Brazil rejoined the group of the ten largest global economies, at market rates. While the agricultural sector led the way with a record grains harvest, growth was broad-based, extending to both the industry and the services sector. Demand was propelled by a strong labor market, with the addition of 1.4 million formal-sector jobs, lower unemployment, and higher real wages. The strong harvest also contributed to the highest exports on record, leading to a trade surplus of almost US\$100 billion. Inflation fell from 5.8 percent in 2022 to 4.6 percent in 2023, within the tolerance interval of the inflation-targeting monetary policy framework and is expected to fall further towards the 3 percent target in 2024.

Economic activity remained strong in the first quarter of 2024 as growth continues to be supported by a strong labor market. GDP increased by 0.8 percent quarter-over-quarter (s.a.), slightly exceeding market consensus, supported by strong private consumption and a rebound in investment. While growth is expected to have moderated in the second quarter, in part reflecting the adverse effects of the devastating floodings in the state of Rio Grande do Sul, credit growth and a robust labor market continued to support domestic demand. Indeed, the latest indicators show a dynamic and marginally stronger labor market in recent months. Formal job creation has gained speed, the participation rate has increased, and real wages have grown faster than anticipated. With stronger than expected economic activity, the market consensus for 2024 GDP growth increased from 1.5 to 2.1 percent between January and May.

We see the balance of risks to the growth outlook as broadly neutral. We appreciate staff's assessment that the balance of risks has improved. However, while we acknowledge that the challenging global scenario poses important downside risks that could impact the Brazilian economy, staff's assessment of domestic risks seems a bit too negative. The devastating floods that hit the state of Rio Grande do Sul resulted in a humanitarian disaster, but the impact on the national economy and overall public spending should be limited. While the state is an important agricultural and industrial producer, supply disruptions tend to be temporary, restricted to the second quarter and to specific sectors, and partially offset by reconstruction efforts in the following quarters.

A New Fiscal Framework and Landmark Tax Reform Reinforce the Commitment to Sustainability

The authorities are committed to ensuring a sustainable path for the primary fiscal balance and public debt, in line with the fiscal framework. The fiscal framework enacted in 2023 constrains expenditures to grow at a pace that is typically below that of revenues. Furthermore, the government established a path of primary fiscal balance targets that will lead public debt to stabilize in 2028 and then decrease. Despite challenging circumstances, the primary deficit in 2023 was in line with the goal set by the government, in part reflecting Congressional approval of important measures to restore revenue sources that had been eroded due to loopholes, temporary exemptions, and other factors. The full impact of these and other revenue measures currently under discussion will be felt from this year onwards, aiding the effort to achieve a zero primary balance target in 2024.

Measures to contain expenditures will be given a higher priority in the authorities' fiscal plans. The ongoing spending reviews will lead to additional measures to streamline expenditures, address budget rigidities, and reinforce the fiscal consolidation. The authorities have expressed their intention to revisit tax expenditures, which amount to almost 5 percent of GDP, in the upcoming 2025 Budget bill to be submitted to the Congress by August. Moreover, there are also important gains to be obtained from reducing leakages in social programs and increasing the efficiency of social spending, which would help deliver the intended results with less budget rigidity. While these are often politically sensitive measures, the plan is to contain spending and rebalance the budget in a way that preserves investment, protects those most in need, and enhances overall fiscal progressivity.

Overall, confidence in Brazil's fiscal sustainability has improved. This can be attested by the upgrades to Brazil's debt rating or outlook by the major rating agencies in 2023. A further demonstration of improved confidence was provided by the high demand for Brazil's largest-ever long-maturity sovereign bond issuance, which resulted in lower-than-expected spreads. A diversified and largely domestic investor base, low foreign currency debt, and large public sector cash buffers mitigate risks and provide room for fiscal consolidation to proceed gradually over the medium term.

The landmark tax reform approved in 2023 will provide an important boost to productivity and economic growth in the medium to long run. The constitutional amendment reshapes Brazil's consumption tax system by replacing five different taxes with a dual VAT, as well as an excise tax on goods and services that are harmful to health or the environment. This long-overdue tax reform – the most significant since the approval of the Constitution in 1988 – will eliminate distortions, avoid race-to-the-bottom tax wars between subnational entities, substantially reduce compliance costs, increase transparency, and reduce litigation. While revenue-neutral on aggregate by design, the reform will lower the tax burden on the consumption basket of the poor. Efficiency gains from the reform are estimated to be

large, potentially reaching more than 10 percent of the level of GDP in steady state. Implementing legislation is under discussion in the Congress and the gradual phase-in of the new tax system will begin in 2026.

Bringing Resilient Inflation Back to the Target Level

A timely monetary policy response helped contain inflation. The BCB began raising rates early in 2021. Since mid-2022, core inflation has receded from a peak of 10.6 percent in June 2022 to 3.5 percent in May 2024. Falling inflation allowed the Central Bank to begin to ease monetary policy in July 2023, having cut the policy rate by a total of 325 basis points.

Recently, the inflation outlook has become more challenging, leading the BCB to interrupt the monetary policy easing cycle. Considering the adverse external environment, resilient economic activity, and inflation expectations above target, the BCB's monetary policy committee (Copom) maintained the policy rate at 10.50% in its latest meeting. The Copom stated that monetary policy would remain contractionary until the disinflation process is firmly consolidated and inflation expectations are anchored at the target.

The floating exchange rate regime continues to play a critical role in helping the economy absorb external shocks. The BCB does not target any level for the exchange rate, intervening only when it deems that foreign exchange (FX) market conditions are dysfunctional. Brazil has an appropriate level of international reserves, and the authorities assess that there is ample and adequate guidance on the use of FX swaps as a policy tool. The stock of FX swaps is determined taking into account both spot and forward market conditions in order to preserve market functioning and reduce the cost of carry. Any eventual change in the stock of FX swaps will be conditional on market developments and will be properly communicated by the BCB in a timely fashion.

Building a Robust and Inclusive Financial System

The financial system remains solid, well capitalized and highly liquid. Capital and liquidity stress tests performed by the BCB indicate that the banking system presents adequate levels of capital and liquid assets in all the simulated adverse scenarios. The growth of fintech companies has led to increased competition and financial inclusion. In order to sustain these welcome developments while preserving financial stability, the BCB has enhanced its oversight of fintech companies through both prudential measures and close monitoring, including through the analysis of the risks of contagion within and between banks and non-bank financial institutions.

Financial innovation is key for greater financial sector competition, efficiency, and financial inclusion. The main planks of the financial innovation strategy are the Open Finance initiative, the highly successful Pix instant payment system, and the developing

Digital Real (Drex). The BCB continues to deepen Brazil's Open Finance environment and the Pix instant payment system. Meanwhile, a third major innovation, Drex, a wholesale CBDC, is nearing the conclusion of the initial phase of the pilot, which has helped to reveal technical issues, including how to ensure the appropriate level of privacy in CBDC transactions. While solutions for the technical issues are being sought, the BCB continues to work with the private sector to develop new use cases for Drex.

Another important focus of the financial agenda is on improving the institutional underpinnings of markets in order to reduce the cost of credit for firms and households.

A new law on collaterals was approved in 2023 to improve the recovery of delinquent loans by increasing the efficiency and availability of collateral. Legislation currently being debated in Congress includes improvements to the insolvency framework for non-financial companies and measures to strengthen minority shareholder rights. To ensure that this cost-of-credit agenda generates the broadest possible benefits, the government implemented the successful Desenrola program to help low-income households restructure their debts, including overdue loans and other past-due obligations such as, for example, utility bills. In a little over six months, the program has helped over 15 million people reorganize their finances and rejoin the formal credit market through the renegotiation of R\$53 billion in overdue obligations.

Boosting Inclusive and Sustainable Growth

The authorities welcome the upward revision in the Fund's medium-term growth projections. A wide-ranging reform agenda is boosting total factor productivity and improving the business environment. The authorities agree that the VAT reform will increase potential growth in the medium to long run through a more streamlined tax system, which will lead to efficiency gains in various sectors—including by reducing compliance costs and rebalancing the tax burden—and create a more favorable environment for private investment.

The Ecological Transformation Plan, a key piece of the government's economic and social development agenda, has started to generate significant results. While Brazil is a green economy leader, producing more than 90 percent of its electricity from clean sources, the Plan aims to promote decarbonization and the green transition. The Plan's first year already produced results, with Brazil's first sustainable sovereign bond issue, a record financial contribution to the Climate Fund, earmarked credit for low-carbon agriculture, a redirection of tax-advantaged infrastructure bond issuance towards social and environmental infrastructure, and significant progress in the proposed carbon market legislation and in the establishment of a national sustainable taxonomy. In addition to the final approval of the carbon market legislation, actions planned include important measures related to renewable energy, green fuels, transportation, forests, and foreign exchange hedging solutions for green transition investments.

Social policies have been a key priority in the authorities' agenda. Transfers to poor families in Brazil with children from zero to 6 years of age enrolled in the Bolsa Familia conditional cash transfer program were increased, mitigating risks to their health and education prospects. This will benefit about 9 million children. In 2023, a landmark Federal Gender Pay Gap Law was enacted. The law requires large employers to bi-annually report on differences in pay between men and women in management and leadership positions. The authorities expect the law to boost female labor force participation and narrow the gender gap.

Navigating the Transition to a More Equitable and Efficient Economy

In sum, while facing important structural challenges, the Brazilian economy has performed well and is on track to become more equitable and more efficient. The authorities are resolved to continue to ensure the convergence of inflation to the target, rebalance the fiscal stance to stabilize public debt and put it on a firmly downward path, and address poverty and inequality in an inclusive and environmentally sustainable growth model. Tapping from the enormous potential for a successful ecological transformation of the economy to tackle the many economic and social challenges will remain a priority. Structural reforms take time and are often politically sensitive, but Brazil has shown over time its ability to move in the direction of a more efficient, sustainable, and just economy.