



BRAZIL

September 2021

2021 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 2021 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 September 10, 2021 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 September 10, 2021, following discussions that ended on July 5, 2021, 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 August 20, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Brazil.

The documents listed below have been or will be separately released.

Selected Issues

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 2021 Article IV Consultation with Brazil

FOR IMMEDIATE RELEASE

Washington, DC – September 22, 2021: On September 10, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Brazil.

Economic performance has been better than expected, in part due to the authorities' forceful policy response. GDP regained its pre-pandemic level in 2021Q1 and momentum continues to be favorable, supported by booming terms of trade and robust private sector credit growth.

Tragically, the COVID-19 pandemic has claimed the lives of more than 550,000 Brazilians. Renewed lockdowns following a severe second COVID-19 wave early this year and the rollout of vaccination have helped bring down infections since April, with new daily COVID-19 cases and deaths falling significantly from their peaks. The government has procured sufficient doses to inoculate the adult population in 2021, with the most vulnerable population expected to be fully inoculated by the end of the year.

Real GDP is projected to grow by 5.3 percent in 2021. An improving labor market and high levels of household savings will support consumption and, as vaccinations continue, pent-up demand will return for in-person services. Depleted inventories will be rebuilt and the upswing in commodity prices will support new investment. Inflation is expected to fall steadily from recent peaks toward the mid-point of the target range by end-2022. After jumping to 99 percent of GDP in 2020, public debt is expected to drop sharply to 92 percent of GDP in 2021 and remain around that level over the medium-term. Uncertainty around the outlook is exceptionally high but risks to growth are viewed as being broadly balanced.

Key challenges remain. Currency depreciation and a surge in commodity prices have fed into headline inflation and inflation expectations even as the output gap remains negative. The labor market is lagging the recovery in output, and the unemployment rate is high, especially among youths, women, and afro-Brazilians. Emergency cash transfers will eventually expire and, in the absence of a permanent strengthening of the social safety net, poverty and inequality could become more acute. Near term fiscal risks are low, but the high level of public debt continues to pose medium-term risks. Restoring high and sustained growth, increasing employment, raising productivity, improving living standards, and reducing vulnerabilities will require policy efforts to eliminate bottlenecks and foster private sector-led investment.

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.

Executive Board Assessment²

Executive Directors commended the Brazilian authorities for their decisive policy response to the COVID-19 shock, which significantly reduced the severity of the 2020 recession and cushioned its impact on the poor and vulnerable while setting the stage for a strong recovery in 2021. Directors welcomed the momentum of institutional reforms, despite the pandemic, to create the foundations for a more competitive economy. However, the pandemic has exacerbated long-standing challenges to higher growth and socio-economic inclusion. Further policy efforts are needed to bolster market confidence, foster private-sector-led investment, and strengthen the medium-term outlook.

Directors agreed that fiscal policy should focus on rebuilding buffers and reducing budget rigidities to create space for public investment and a stronger social safety net. The expenditure ceiling has played an important role in maintaining market confidence and continued adherence to the rule is necessary to reduce public debt. Comprehensive tax reform should aim to increase progressivity, simplify the system, and improve resource allocation. The tax reform should include a bold plan to scale back tax expenditures to frontload the benefits to equity and efficiency. Directors encouraged the authorities to adopt a more robust medium-term fiscal framework and strengthen subnational finances. These measures would help enhance fiscal credibility, reduce fiscal risks, and improve the capacity of the government to manage adverse shocks.

Directors supported the ongoing steady tightening of monetary policy to address rising inflation and keep inflation expectations well-anchored. Given the uncertainty around the outlook, policy would need to continue being data dependent, complemented with proactive communication and clear forward guidance. Directors welcomed the authorities' commitment to a flexible exchange rate and to limit intervention to countering disorderly market conditions.

Directors noted that the banking system has been resilient and has supported the recovery. They agreed that a gradual phasing out of crisis-related financial support is appropriate and endorsed the authorities' efforts to enhance financial inclusion and promote competition in the banking system.

Directors welcomed the ambitious supply-side reform agenda aimed at boosting productivity, potential growth, and living standards. Concerted action is needed to liberalize foreign trade and product markets, increase formal labor market flexibility, and improve governance. Strengthening the effectiveness and predictability of the anti-corruption and AML/CFT frameworks remains critical. Steps are also needed to further improve the environment for private sector investment.

Directors welcomed initiatives to foster environmentally sustainable activities in response to climate-related risks. Many Directors encouraged closer collaboration between the authorities

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 summing up can be found here: <http://www.IMF.org/external/np/sec/misic/qualifiers.htm>.

and staff to analyze climate-related risks in macroeconomic assessments and evaluations of financial stability.

Table 1. Brazil: Selected Economic Indicators

I. Social and Demographic Indicators																			
Area (thousands of sq. km)	8,510	Health																	
Agricultural land (percent of land area)	30.2	Physician per 1000 people (2018)																	
Population	210.1	Hospital beds per 1000 people (2018)																	
Total (million) (est., 2019)	210.1	Access to safe water (2018)																	
Annual rate of growth (percent, 2018)	0.8	Education																	
Density (per sq. km.) (2019)	25.3	Adult illiteracy rate (2019)																	
Unemployment rate (2019)	11.9	Net enrollment rates, percent in:																	
Population characteristics (2018)		Primary education (2019)																	
Life expectancy at birth (years)	76	Secondary education (2019)																	
Infant mortality (per thousand live births)	12	Poverty rate (in percent, 2018) 1/																	
Income distribution (2017)		GDP, local currency (2020)																	
Ratio between average income of top 10 percent of earners over bottom 40 percent	12.4	GDP, dollars (2020)																	
Gini coefficient (2018)	53.9	GDP per capita (2020)																	
Main export products: airplanes, metallurgical products, soybeans, automobiles, electronic products, iron ore, coffee, and oil.																			
II. Economic Indicators																			
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026									
	(Percentage change)																		
National accounts and prices																			
GDP at current prices	5.0	6.4	5.8	0.6	15.0	7.8	6.1	6.4	6.2	6.1									
GDP at constant prices	1.3	1.8	1.4	-4.1	5.3	1.9	2.0	2.1	2.1	2.1									
Consumption	1.4	2.0	1.6	-5.3	3.5	1.6	1.5	1.5	1.5	1.4									
Investment (GFCF)	-2.6	5.2	3.4	-0.8	11.8	4.1	5.0	5.2	4.0	4.0									
Consumer prices (IPCA, end of period)	2.9	3.7	4.3	4.5	5.8	3.7	3.3	3.0	3.0	3.0									
(Percent of GDP)																			
Gross domestic investment																			
Private sector	12.3	13.0	13.3	12.7	14.5	14.6	15.1	15.8	16.2	16.6									
Public sector	2.3	2.1	2.1	2.7	2.0	2.3	2.3	2.2	2.2	2.2									
Gross national savings																			
Private sector	20.1	18.6	17.2	26.6	22.1	21.5	20.6	20.1	19.7	19.6									
Public sector	-6.5	-5.9	-4.7	-11.6	-5.2	-5.6	-5.0	-4.5	-4.0	-3.6									
Public sector finances																			
Central government primary balance 2/	-1.9	-1.8	-1.3	-10.0	-1.9	-0.8	-0.3	0.2	0.7	1.2									
NFPS primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2									
NFPS cyclically adjusted primary balance (in percent of potential GDP)	-0.9	-1.1	-0.5	-7.7	-1.5	-0.9	-0.3	0.2	0.7	1.2									
NFPS overall balance	-7.9	-7.1	-5.9	-13.4	-6.3	-6.9	-6.2	-5.7	-5.2	-4.8									
Net public sector debt	51.4	52.8	54.6	62.7	63.9	66.4	69.4	71.8	72.6	74.6									
General Government gross debt, Authorities' definition	73.7	75.3	74.3	88.8	82.6	81.8	83.2	84.0	83.6	84.5									
NFPS gross debt	83.6	85.6	87.7	98.9	91.6	90.9	91.7	92.0	92.1	92.0									
Of which: Foreign currency linked	3.6	4.1	4.2	5.8	5.2	5.0	4.9	4.9	4.8	4.7									
Money and credit	(Annual percentage change)																		
Base money 3/	9.6	1.6	3.3	8.0	15.0	7.8	6.1	6.4	6.2	6.1									
Broad money 4/	4.6	8.1	8.6	18.6	13.9	10.1	8.1	7.9	8.0	7.8									
Bank loans to the private sector	0.0	7.7	5.9	16.4	10.0	9.0	9.0	8.0	8.0	8.0									
(Billions of U.S. dollars, unless otherwise specified)																			
Balance of payments																			
Trade balance	57.3	43.4	26.5	32.4	76.1	63.4	55.9	49.7	50.0	50.8									
Exports	218.0	239.5	225.8	210.7	281.2	280.4	279.9	283.6	294.0	304.4									
Imports	160.7	196.1	199.3	178.3	205.2	217.0	224.1	234.0	244.0	253.6									
Current account	-22.0	-51.5	-65.0	-25.9	7.1	-19.1	-38.3	-54.1	-64.5	-74.2									
Capital account and financial account	17.5	52.8	64.7	22.8	-7.1	19.1	38.3	54.1	64.5	74.2									
Foreign direct investment (net inflows)	47.5	76.1	46.4	48.1	57.9	64.8	69.5	72.8	75.9	74.3									
Terms of trade (percentage change)	15.6	-2.2	0.6	-7.0	15.1	-3.9	-1.6	-1.3	-1.1	-0.9									
Merchandise exports (in US\$, annual percentage change)	18.3	9.9	-5.7	-6.7	33.5	-0.3	-0.2	1.3	3.6	7.3									
Merchandise imports (in US\$, annual percentage change)	15.0	22.1	1.6	-10.5	15.0	5.8	3.2	4.4	4.3	8.4									
Total external debt (in percent of GDP)	32.3	34.7	36.0	44.3	37.7	31.8	29.3	27.5	26.3	25.8									
Memorandum items:																			
Output Gap	-2.9	-1.9	-1.3	-4.0	-0.7	-0.4	-0.2	0.0	0.0	0.0									
Current account (in percent of GDP)	-1.1	-2.7	-3.5	-1.8	0.4	-1.0	-1.8	-2.3	-2.6	-2.8									
Unemployment rate	12.7	12.3	11.9	13.5	13.7	12.9	11.7	10.9	10.2	9.8									
Gross official reserves	374	375	357	356	353	353	353	353	353	353									
REER (annual average in percent; appreciation +)	8.5	-10.4	-1.8	-20.6									

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

1/ Computed by IBGE using the World Bank threshold for upper-middle income countries of U\$5.5/day. This number is not comparable to the estimates provided by IPEA in previous years due to methodological differences.

2/ Includes the federal government, the central bank, and the social security system (INSS). Based on the 2017 draft budget, recent announcements by the authorities, and staff projections.

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

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



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STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

August 20, 2021

KEY ISSUES

Context. Economic performance has been much better than expected, in part due to the authorities' forceful policy response. Nevertheless, Brazil's long-standing challenges of low growth, high debt, and elevated levels of poverty and inequality have been exacerbated by the pandemic. Tragically, more than 550,000 Brazilians have died from COVID-19.

Recent Developments. Brazil is past the peak of a severe second wave of the pandemic and, after a slow start, vaccinations are progressing well. GDP regained its pre-pandemic level in 2021 Q1 and momentum continues to be favorable, supported by booming terms of trade and robust private sector credit growth. The surge in commodity prices and a weaker currency compared with pre-crisis levels has fed into headline inflation and inflation expectations, leading the Central Bank to initiate a tightening cycle. The labor market is lagging the recovery in output, and the unemployment rate remains high, especially among the young, women, and afro-Brazilians.

Outlook and Risks. Real GDP is projected to grow by 5.3 percent in 2021. Inflation is forecast to fall steadily from the July peak toward the mid-point of the target range by end-2022. After jumping to 99 percent of GDP in 2020, public debt is expected to drop sharply in 2021 and remain around 92 percent of GDP over the medium-term. Uncertainty around the outlook is exceptionally high but risks to growth are viewed as being broadly balanced.

Policy Recommendations. Despite the strong cyclical recovery, monetary and fiscal policy face difficult choices and further institutional reforms—to improve the composition of tax and spending, strengthen governance, and raise labor productivity growth—remain critical to strengthen the medium-term outlook.

- **Fiscal policy:** The 2021 round of targeted COVID-19 spending will protect the most vulnerable and support the recovery. Medium-term consolidation is appropriately guided by the constitutional expenditure ceiling. Reducing budget rigidities and mandatory outlays will be key to create the fiscal space needed for high priority programs and to increase the flexibility in responding to shocks. Tax expenditures should be scaled back alongside a broader tax reform that increases progressivity, reduces the misallocation of resources, and raises potential growth. Developing a full-

fledged medium-term fiscal framework at the federal level and imposing credible hard budget constraints at the subnational level will further support fiscal credibility.

- **Monetary and exchange rate policy.** A steady upward path for the policy rate should ensure inflation returns to the mid-point of the target band by end-2022. Given the uncertainty around the outlook, policy will need to be data dependent and be particularly cognizant of shifts in inflation expectations. Continued clear forward guidance that is linked to economic outcomes and articulates the timeline and pace at which the BCB's inflation goal is expected to be reached will be important. Foreign exchange (FX) intervention should be limited to countering dysfunctions in FX markets.
- **Financial sector.** The banking system remains resilient. Careful supervisory oversight should continue while a gradual withdrawal of extraordinary crisis support measures is appropriate. Promising efforts to improve financial sector competition, expand financial inclusion, and promote green financing should be deepened.
- **Institutional reforms.** Despite the pandemic, important market-oriented measures have been taken to create the foundations for a more competitive economy. Additional decisive steps are needed, including a comprehensive tax reform that simplifies the system and reduces the cost of tax compliance, further easing the stringency and complexity of market regulations, reducing barriers to entry in network sectors, liberalizing trade, and improving governance.

Approved By
Nigel Chalk (WHD)
and Bikas Joshi (SPR)

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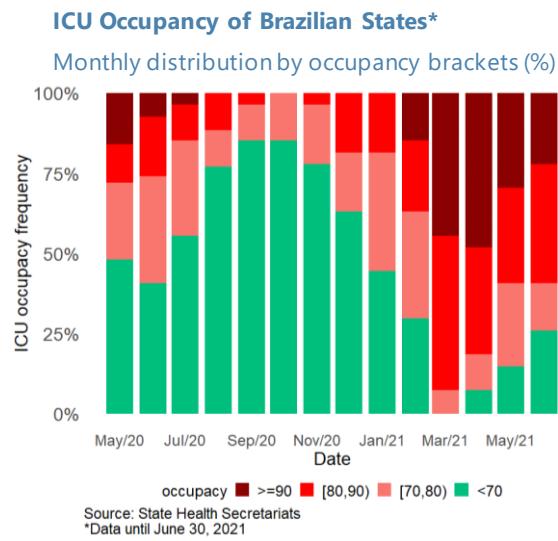
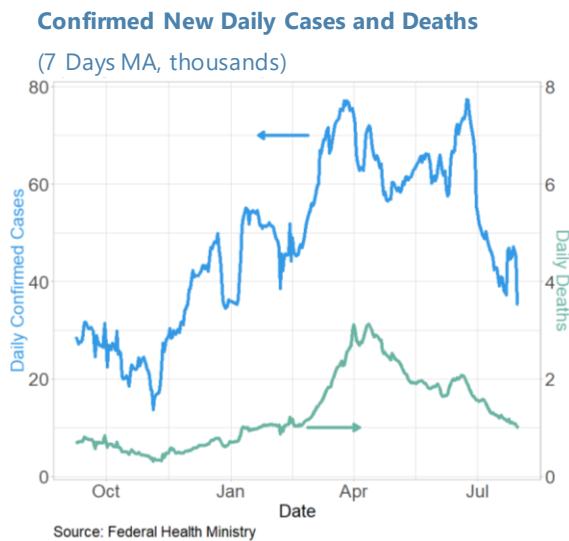
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CONTEXT

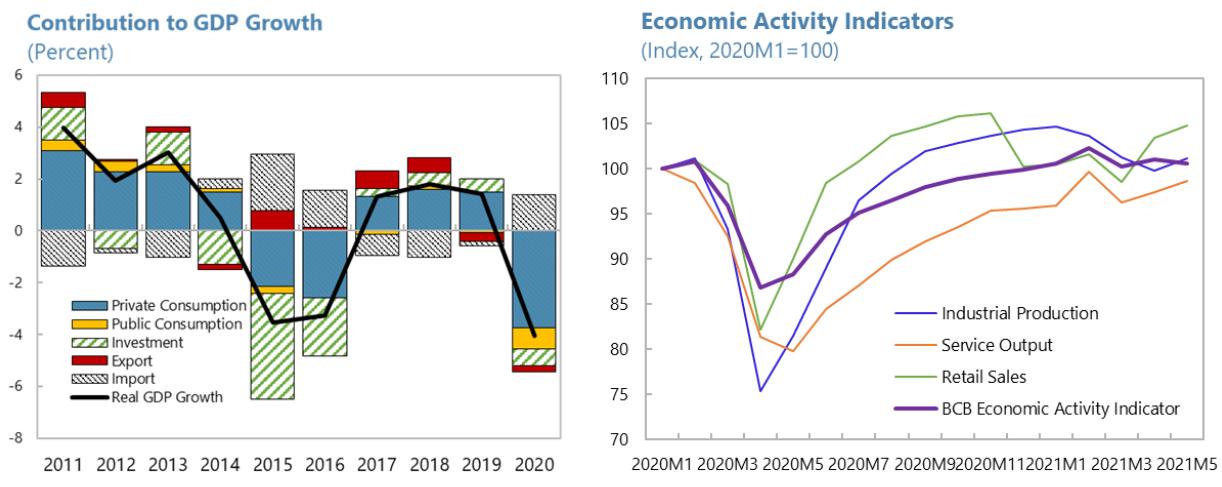
1. New COVID-19 cases are on a downward path following a second wave early this year (Figure 1). The emergence of a more contagious and lethal variant of the virus, coupled with near pre-pandemic social mobility levels in late-2020, pushed daily infections and fatalities to new highs in April. However, renewed lockdowns and the rollout of vaccination have helped bring down infections since April. New daily cases have declined to 45,000 and daily deaths have more than halved to 1000. Tragically, more than 550000 Brazilians have died and average life expectancy at birth has fallen by 1.3 years¹.

2. Vaccinations are progressing well. The vaccination campaign, which started in mid-January, has accelerated since March after local production of vaccines was scaled up. As of end July, 50 percent of the population and more than 90 percent of those over 60 had received at least a first dose. The government has procured sufficient doses to inoculate the adult population in 2021, with the most vulnerable populations expected to be fully inoculated by the fall.



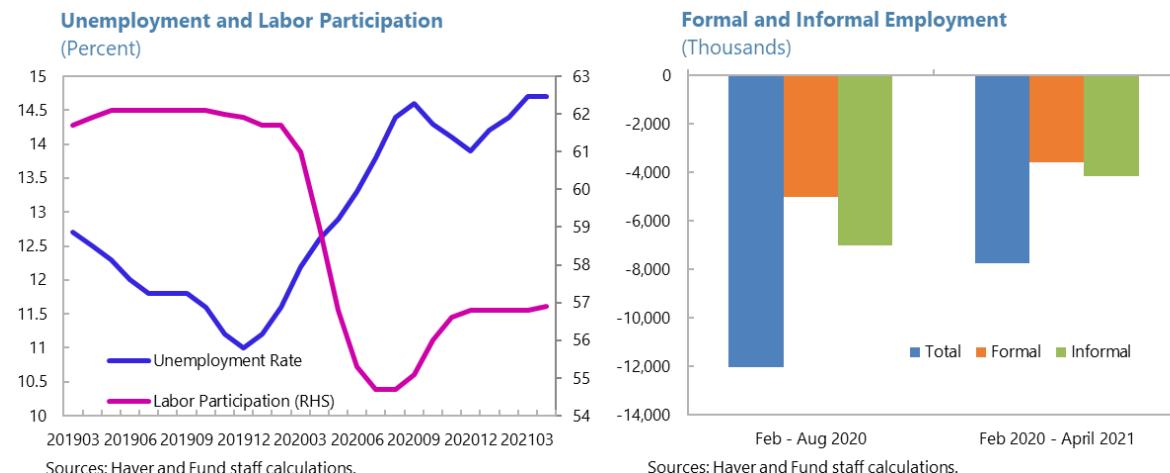
3. Sustained by strong policy support, the economy withstood well the health crisis. Real GDP declined by 4.1 percent in 2020, less than in most advanced and emerging economies and the smallest contraction among the major Latin American economies (Box 1). The fall in private consumption was cushioned by about 4 percent of GDP in cash transfers to vulnerable households and informal workers (Box 2). At the same time, substantial liquidity support and capital relief measures ensured the financial system was resilient and banks remained profitable. Private sector credit grew robustly, buoying housing demand and residential construction, while a sharp decline in imports led to a positive contribution to growth from net exports. After contracting by 6.1 percent in H1 2020, the economy returned to its pre-pandemic level by Q1 2021. The recovery has been led by industry and agriculture, with the service sector still struggling (Figure 2).

¹ Castro, M.C., Gurzenda, S., Turra, C.M. et al. Reduction in life expectancy in Brazil after COVID-19. *Nat Med* (2021). <https://doi.org/10.1038/s41591-021-01437-z>



Sources: Haver and Fund staff calculations.

4. The labor market is lagging the recovery in output. Labor market data covering both the formal and informal sectors suggest that only 4.2 million of the 12 million jobs lost between February and August 2020 were recovered by April 2021.² The unemployment rate remains high and labor force participation has leveled off at a lower level than prior to the pandemic. At end-March, the youth unemployment rate was 31 percent while the unemployment rate of afro-Brazilians and women was 18-19 percent. Female labor force participation is only 48 percent versus 67 percent for men. Moreover, the pipeline of skilled labor supply has been adversely affected; the World Bank expects a roll back of the decade-long improvement in the Human Capital Index.



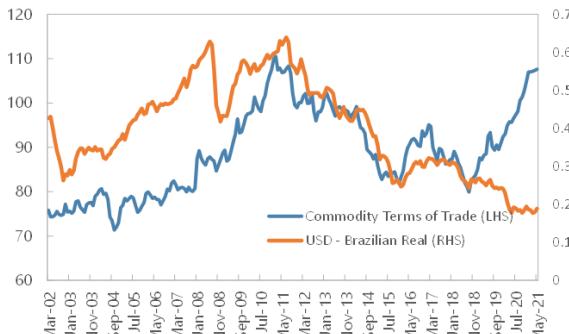
Sources: Haver and Fund staff calculations.

5. The current account deficit has shrunk, from -3.5 percent of GDP in 2019 to -1.7 in 2020, supported by a historic increase in private savings (Box 3, SIP). The current account deficit has been financed by FDI inflows offset by modest portfolio outflows (Figure 3). The exchange rate depreciated sharply as the pandemic worsened, but the increase in commodity prices since late 2020 has helped strengthen the *Real* albeit less than would be implied by historical correlations. The

² Nevertheless, with administrative data for the formal sector pointing to a much faster recovery than the official labor market survey, visibility on the true state of the labor market is somewhat limited.

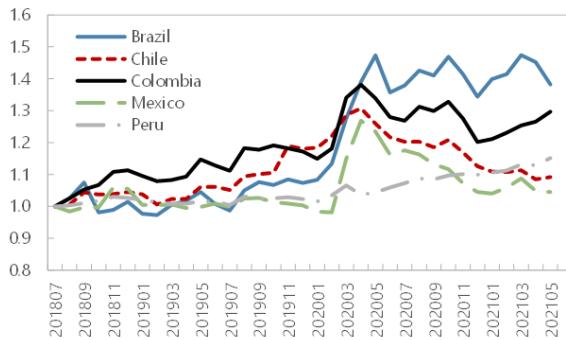
BCB intervened to dampen excessive volatility.³ Reserves remain adequate (above the upper bound of the recommended range for the ARA metric, Annex I) and the upcoming SDR allocation will increase gross reserves by 4 percent. The 2020 external position is judged to be broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex I).

Brazil: Commodity Terms of Trade and Exchange Rate



Source: Haver and Fund staff calculations.

Latin American Exchange Rates versus USD
(Index, July 2018 = 1)

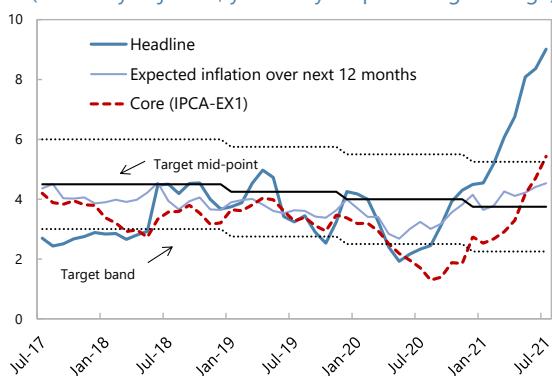


Source: Haver and Fund staff calculations.

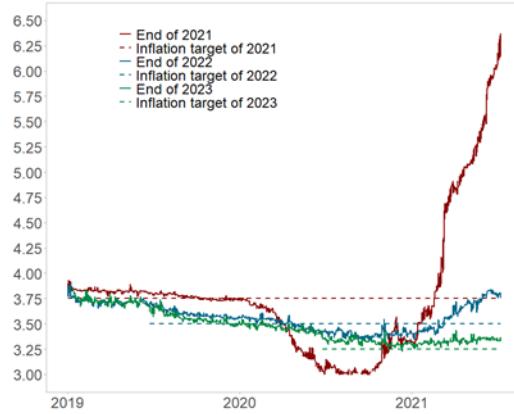
6. Inflation has risen above the target, prompting the BCB to tighten policy. Headline inflation has been above target⁴ since November 2020, reaching 9 percent in July 2021, reflecting higher fuel and commodity prices as well as supply disruptions and demand pressures (Figure 4, Box 4). Core inflation was 5.4 percent in July. Near-term inflation expectations have risen sharply but are anchored at a longer-horizon. The BCB hiked the policy rate by 325 bps between March and August, raising the SELIC from 2 to 5.25 percent.

Headline and Core Inflation

(Seasonally adjusted, year-on-year percentage change)



Expected CPI-inflation rate (mean)
As of each date in the x-axis, for the year of reference

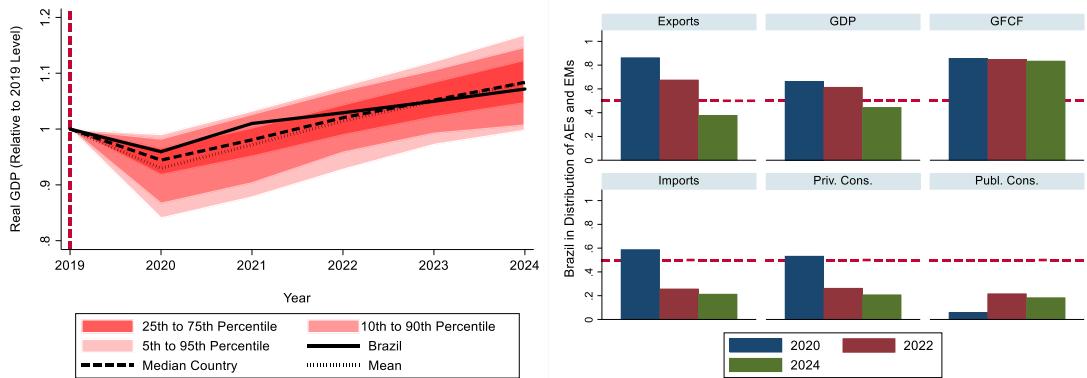


³ During the acute first wave of the pandemic in March-June 2020, the BCB increased the outstanding stock of FX swaps—non-deliverables and settled in local currency—by US\$18 billion and undertook US\$19 billion in spot intervention. In early 2021, when the second wave hit and fiscal risks moved into focus during the budget discussions, the stock of FX swaps rose by a further US\$18 billion.

⁴ The target rate is 3.75 percent for 2021 and 3.5 percent for 2022, with tolerance intervals of +/- 1.5 percent.

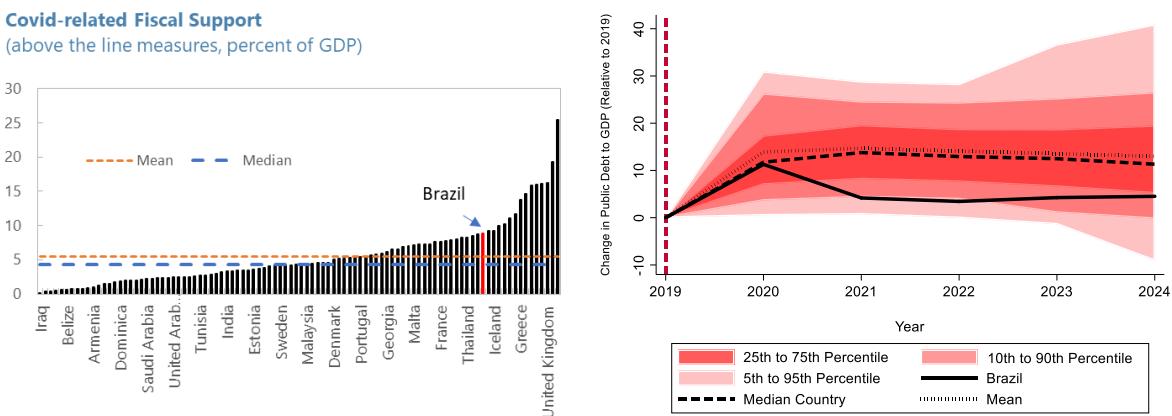
Box 1. Brazil's COVID Economy in International Context

Brazil's 2020 recession was less severe than comparators in a broad sample of advanced and emerging economies (roughly at the 25th percentile of countries). Brazil's GDP contraction was smaller than the contraction in other countries (the median country experienced a drop of 5.5 percent). The relatively strong performance in Brazil was driven by exports and investment which dropped significantly less than in other countries, and to a lesser extent private consumption.



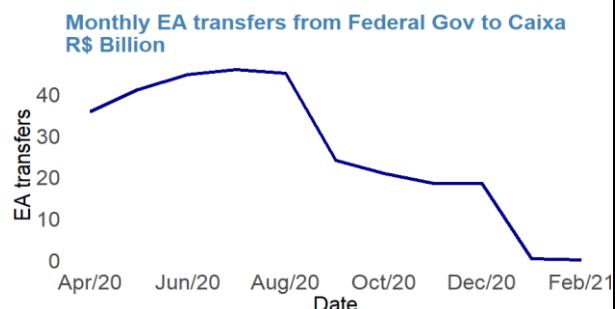
With strong growth projected for 2021, Brazil will end the year among the top decile of countries in terms of the level of GDP, converging to the median by 2022. Investment performance is expected to remain strong during the forecast horizon, but private consumption will slow down relative to comparators. With weaker projected potential growth than most peer countries, Brazil's level of GDP will be slightly below the median country by 2024.

Brazil's 10 percentage point increase in debt to GDP in 2020 is in line with comparator countries but the large drop in 2021 stands out. The size of Brazil's fiscal response was larger than most comparator countries but the strong GDP outcome meant the increase in gross debt to GDP in 2020 was similar to other countries. With a strong increase in nominal GDP, low effective interest rates, and a fast-declining primary deficit, Brazil's public debt will come down faster than most countries in 2021. Nonetheless, the absolute level of Brazil's debt will remain higher than most peers.



Box 2. The Growth and Employment Effects of the Emergency Aid Program¹

The emergency cash transfer program injected nearly 4 percent of GDP into the economy in 2020. The program focused on informal workers and poor households and covered 67 million recipients (nearly two-thirds of Brazil's pre-pandemic workforce) with a monthly benefit of R\$600 from April to August 2020. In the remainder of 2020, the transfers were restricted to approximately 45 million recipients, with a monthly payment of R\$300. The program prevented a sharp rise in poverty and inequality.¹



The GDP multiplier of the program is estimated to be in the range of 0.6-1.2. Given substantial regional variation in the number of recipients, the impact of the program can be traced through monthly formal employment data at the municipal level. We estimate a cross-sectional instrumental-variables regression for the period April-September 2020 (during which most disbursements occurred). We also interact transfers with municipal (pre-pandemic) informality to account for the fact that fewer formal jobs will be generated where informality is larger, all else equal.

Estimates suggest that each R\$100,000 in transfers generated 0.6 to 1.2 formal jobs over a six-month period and carried an aggregate annual output multiplier of 0.6 to 1.2. This would imply that spending under the program created close to 1 million *formal* jobs in 2020 and added 2.5 percentage points to the level of 2020 GDP, using the lower bound of the estimated range.

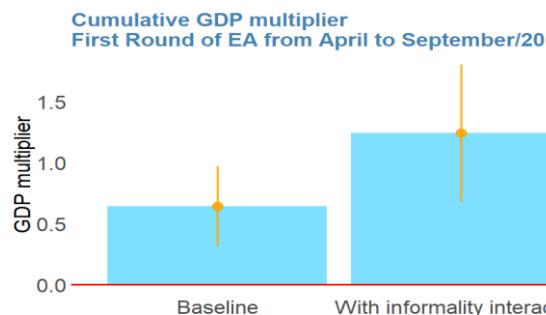


Table 1: GDP Multiplier at Different Horizons

	EA time Horizon:		
	3 months (1)	6 months (2)	9 months (3)
Cost per Year-Job Baseline Specification (BRL)	314,392	314,254	473,148
GDP Multiplier	0.61*** (0.11)	0.64*** (0.17)	0.43 (0.27)
Implied Total Impact on Annual GDP (Percentage Point)	2.44	2.56	1.72
Implied number of Year-Formal Jobs Created	954,222	954,641	634,051
Observations	5,475	5,479	5,480

*p<0.1; **p<0.05; ***p<0.01

The demand effect is estimated to be largest in the initial months of the cash transfer program. Re-estimating the regression for different sample periods (April-June and April-December) shows that the multiplier drops off by Q4 2020. A possible explanation is that transfers were incident on liquidity constrained consumers (and so had a large immediate effect) at the pandemic onset. However, as the economy recovered there were fewer liquidity constrained households and so the transfers had a smaller multiplier effect even though they became better targeted.

¹ See Al Masri, Flamini and Toscani (2021) for the distributional impact of the EA and Chodorow-Reich (2019) for the methodology of transforming local employment multipliers into GDP multipliers. Cunha and others (forthcoming) present the details of the analysis summarized in this box.

Box 3. Explaining External Sector Dynamics During COVID-19

Brazil's current account improvement of 1.8 percent of GDP was broadly in line with its historical average even though most factors would point toward a smaller-than average adjustment. The COVID-19 crisis has been one of the most global and synchronized recessions. Historical experience suggests that recessions that are more globally synchronized would lead to smaller current account improvements as exports fall along with imports. In Brazil, investment and public saving typically decline by around 3 percent of GDP in the short-term following a recession. The increase in private savings has tended to be muted compared to other countries in the past, suggesting less need or scope for deleveraging by households or firms.

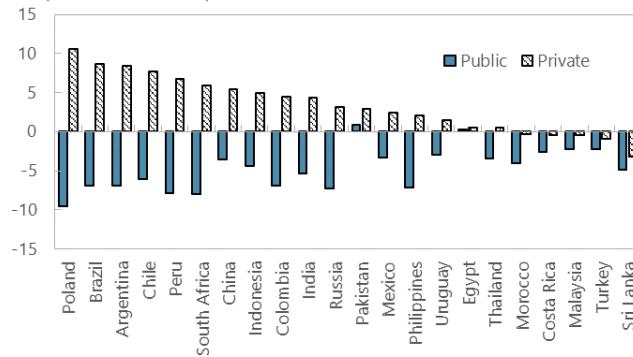
During the pandemic, higher private saving was the main factor driving the adjustment in the current account.

The increase in private savings, one of the largest among major EMs, offset substantial public dissaving. Households were able to save thanks to large cash transfers and stringent lockdowns (early in the pandemic) led to reduced consumption possibilities, particularly for middle to upper income households. At the same time, fears of job losses and heightened anxiety about economic prospects led to increases in precautionary savings.

The improvement in the current account is expected to be persistent. While increases in current accounts tend to be more persistent in advanced economies (lasting up to 8-10 years), shifts in emerging markets' current account balances typically take 4-6 years to unwind.

Changes in Public and Private Saving, 2019-20

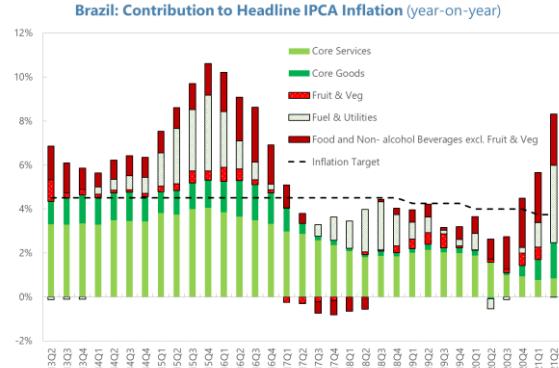
(Percent of GDP)



Box 4. Explaining the Recent Spike in Inflation

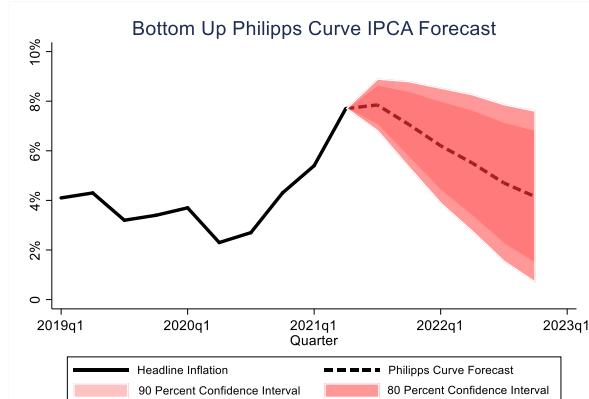
A Phillips curve relationship using quarterly data since 2013 is estimated for each of the five categories of the consumption basket. The results show that:

- Food and beverage inflation are almost entirely explained by changes in international prices and movements in the nominal exchange rate.
- Services inflation is persistent and strongly influenced by labor market slack.
- Non-energy, non-food goods inflation is strongly related to long-term inflation expectations.



Relative to the estimated Phillips curve, core goods inflation surprised to the upside in both Q1 and Q2 2021 and fuel and utilities inflation surprised on the upside in Q2. The relative demand shift towards goods is a likely explanation for these upside surprises.

The Philips curve predicts a consistent downward path from Q4 2021 onwards. Core inflation remains highly stable and very close to target with a higher services inflation offset by a falling goods inflation. Headline inflation is forecast to return to target by end-2022 with food and beverage inflation projected to dissipate although fuel and utilities inflation is expected to be somewhat more persistent. However, the confidence intervals are wide, pointing to substantial model uncertainty.



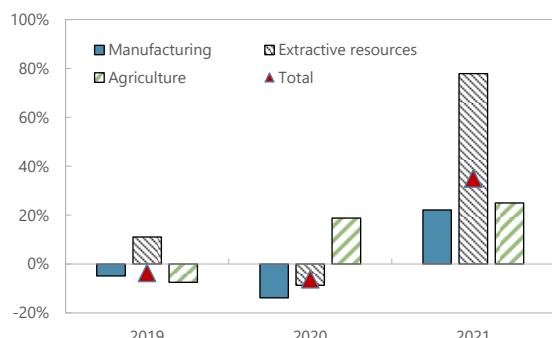
OUTLOOK AND RISKS

7. A strong cyclical recovery is underway. Real GDP growth is expected to rebound to 5.3 percent in 2021. An improving labor market and high levels of household savings will support consumption and, as vaccinations continue, pent-up demand will return for in-person services. Inventories will be rebuilt and the upswing in commodity prices will support new investment. Headline inflation is projected to peak above 8 percent in mid-2021 but core inflation will remain within the target range. Headline and core inflation are expected to converge to the mid-point of the range (3.5 percent) by end-2022 as short-term relative price pressures dissipate.

8. Booming export revenues are expected to anchor a strong external position. High commodity prices and a record soybean harvest are expected to increase exports by one-third in 2021, leading to a trade surplus of 4-5 percent of GDP and a current account close to balance. FDI is expected to pick up in 2021 and aggregate portfolio flows, supported by a rising interest rate differential, will be close to balance in 2021 following several years of outflows. Over the medium

term, the recovery in imports is expected to increase the current account deficit (to around 2.5 percent of GDP, close to its norm). External debt is assessed to be sustainable over the medium term, but subject to risks as the debt path remains sensitive to real exchange rate shocks (Annex II).

**Brazil: H1 Nominal Export Growth by Export Category
(year-on-year)**



Source: SECEX and Fund staff calculations.

Brazil: External Sector Overview

	Actual	Projection	
In billions of USD	2019	2020	2021
Gross External Financing Needs	243	181	139
of which CA deficit	65	26	-7
of which amortization of external debt	178	155	146
Available Financing	216	159	158
of which FDI (net)	46	48	58
of which disbursement of external debt	168	159	144
of which equity portfolio investment (net)	-10	-17	-11
Change in Reserves	-18	-1	-2
Gross International Reserves (end of year)	357	356	353
GIR/ARA (in percent)	147	161	159
<i>Memo items</i>			
Implicit Debt Rollover Rate (percent)	95	102	98
Annual Change in Nominal Exports (percent)	-6	-7	33
Annual Change in Nominal Imports (percent)	2	-10	15

9. Uncertainty around the baseline is significant but risks to growth are viewed as being broadly balanced (Annex III). A delayed vaccine rollout or new virus variants would hinder the recovery of the service sector and the ongoing normalization of labor markets, posing a first order risk to activity (Box 5). A drought-induced rationing of energy and/or a spike in electricity prices also represent important downside risks. However, the recent strong momentum in activity and a waning effect of the pandemic on economic outcomes both provide an upside to the outlook. A reassessment of market fundamentals—which could arise from concerns over the implementation of the fiscal policy framework, realization of contingent liabilities (¶14), and electoral uncertainties—and/or a tightening of global financial conditions could lead to capital outflows, a higher cost of budget financing, a weaker currency, and additional inflationary pressures. In confronting these risks, the flexible exchange rate regime remains an indispensable shock absorber. These risks are further mitigated by a sound banking system, a large stock of international reserves, and a low share of foreign currency public debt.

Authorities' Views

10. The authorities agreed that the baseline economic outlook looks favorable. The BCB pointed to the resilience of private consumption despite the COVID-19 resurgence and the temporary interruption in emergency aid benefits and agreed that the normalization of the household savings rate will continue to boost consumption. The Ministry of Economy highlighted that Brazil is one of the very few countries in which market friendly structural reforms have been moving ahead despite the pandemic. The authorities attributed the strong economic recovery as a validation of their approach to shift from state-driven to private sector-led growth. Current measures to preserve employment and income, recent progress in the vaccination campaign, and high prices of commodity will continue to support the economic recovery.

Box 5. An Extended SEIRD Model to Assess the Impact of Vaccination on Mobility

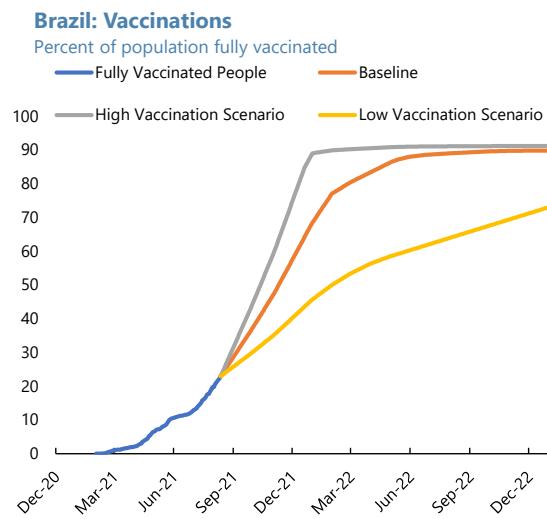
To examine how vaccinations can affect economic activity, an extended SEIRD model developed by Dizioli and Radzikowski (2021) was used to assess how mobility and deaths would change under alternative vaccination profiles. Given the large economic impact that mobility has, especially on high contact sectors, the economic returns to widespread vaccination are high.

Using actual vaccination rates for fully vaccinated individuals as of April 30th, 2021 (6.4 percent of the population), the model assumes that the fully vaccinated population will increase steadily until 88 percent of the population are fully vaccinated.

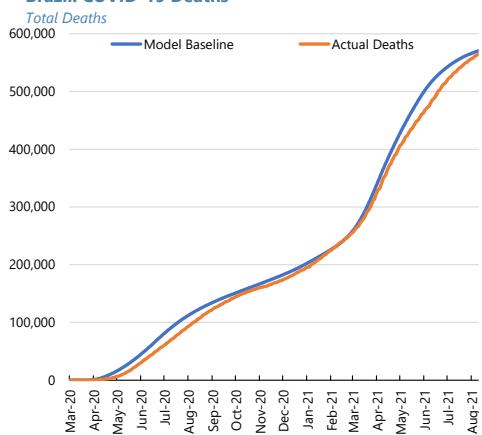
In the baseline scenario, 75 percent of vulnerable individuals are vaccinated by June 9th, 2021, while the non-vulnerable population will reach this same threshold on April 11, 2022. Two alternative scenarios are considered; one which accelerates vaccinations by 3 months for the non-vulnerable population, and another which assumes a delay of 6 months for the non-vulnerable population.

The results show that a speedier 3-month vaccination conclusion could allow mobility to be 3 percent higher in 2022 while keeping the number of deaths the same.

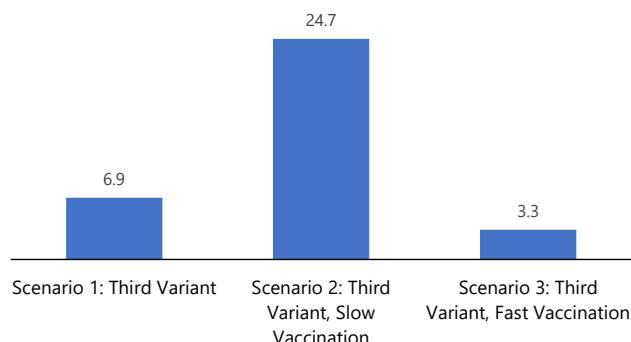
On the other hand, if vaccination is delayed by 6 months, then mobility would need to fall by 13 percent in 2022 to keep the number of deaths the same. This quantifies the epidemiological and economic gains of a speedier delivery of vaccination in the coming months.



Brazil: COVID-19 Deaths



Additional Deaths Relative to Baseline
(percent, through December 31st, 2022)



Prepared by Allan Dizioli and Daniel Greenwood (RES)

POLICIES TO SUPPORT A SUSTAINED RECOVERY

A. Spending and Taxing Better

12. Unprecedented fiscal support in 2020 resulted in the largest fiscal deficit on record. In March 2020, Congress declared a “state of public calamity” through end-2020, to pave the way for an emergency package of fiscal (the “war budget”) and quasi-fiscal measures of 17.6 percent of GDP—almost half of it with a direct impact on the primary deficit (text table).⁵ Cash transfers to households (4 percent of GDP) were at the core of the fiscal package. The NFPS primary deficit rose by 7.3 percentage points to 9.2 percent of GDP and gross debt reached 99 percent of GDP by end-2020.

COVID-19 Response - Fiscal and Quasifiscal measures announced by the Federal Government, 2020-21

(Percent of GDP, estimates and announcements as of May 7, 2021)

	2020		2021	
	announced	execution 1/	new policies	execution 2/
Fiscal and quasi-fiscal measures 3/	17.6	16.5	2.1	2.4
Fiscal measures affecting the government accounts 4/	12.1	11.0	2.1	2.4
Direct impact of measures on primary deficit	8.3	7.3	1.1	1.4
Revenue Measures (taxes)	0.4	0.4
Expenditure measures 5/	6.0	5.0	1.1	1.4
Income Transfers to Households	4.3	4.0	0.7	0.8
Employment support	0.7	0.4	0.1	0.1
Covid19-related health spending	1.1	0.7	0.2	0.5
Supplementary Transfers to Subnational Governments (non-health related)	1.9	1.9
Credit support to firms 6/	1.1	1.0	0.1	0.1
Credit to finance SMEs payroll and the tourism sector	0.2	0.2	...	0.02
Capitalization of guarantee funds to support credit to SMEs	0.9	0.8	0.1	0.1

1/ Tax and quasi-fiscal measures are assumed to have been executed in the announced amount.

2/ Total expected execution of 2020-21 crisis-response policies.

3/ Includes public banks' Covid-related lending programs and use of public funds which were previously earmarked for other purposes.

4/ Includes within-year frontloading of benefit payments and tax deferrals, as well as credit support from the Federal Government.

5/ For 2021, includes the original amounts foreseen in the ‘Emergency’ constitutional law plus subsequent extensions of existing programs.

6/ Financial operations (below-the-line items).

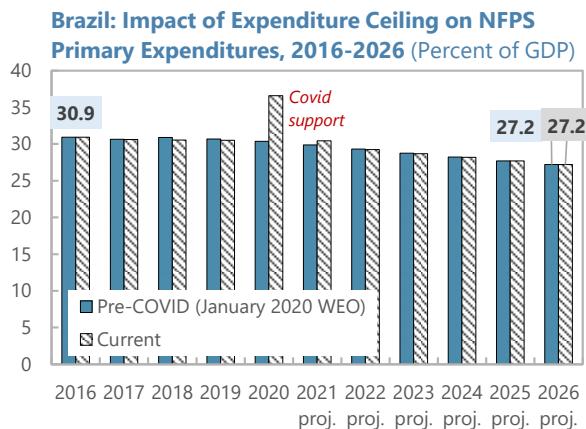
13. In March 2021, Congress approved an emergency constitutional amendment with a new round of COVID-19 support and limits on spending growth over the medium term. The near-term support of 1.4 percent of GDP—consisting of cash transfers to poor households, support for employment and credit incentive programs, and dedicated funds for health spending—was excluded from the expenditure rule. However, automatic spending limits will be triggered if mandatory primary expenditures exceed 95 percent of total spending (a condition that is not

⁵ The state of public calamity was necessary to suspend the government’s obligation to comply with the primary balance target. Congress also ratified a constitutional amendment to allow the separation of deficit impacting COVID-19 expenses from the ordinary budget of the Federal Government, creating a “war budget” that was exempted from the “golden rule” (which prohibits government borrowing to finance current expenditures).

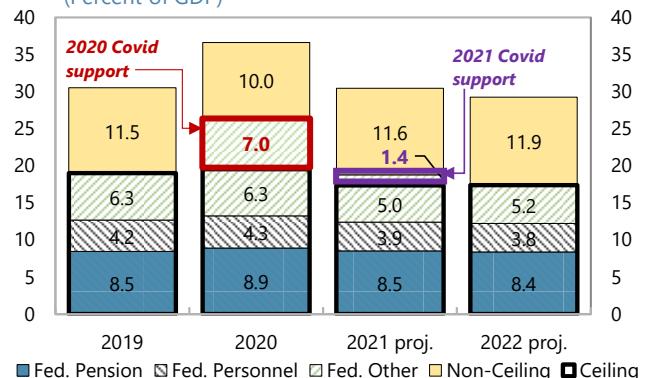
expected to bind in the next 3-4 years).⁶ The emergency amendment also formalized the “public calamity” clause, authorizing the suspension of fiscal rules in future crises and prohibiting any public wage increases or new mandatory spending while the state of calamity is in effect.

14. Fiscal consolidation has resumed. The NFPS primary deficit is expected to narrow substantially from 9.2 percent last year to 1.7 percent of GDP in 2021, due to the expiration of the “war budget”, reduced COVID-19 support, restraints on subnational wage increases, buoyant tax revenues, and the payment of deferred taxes. Fiscal space, though, remains at risk. Adherence to the expenditure ceiling will help rebuild fiscal buffers, with Brazil’s fiscal position improving by around 0.5 percent of GDP per year, reaching a small primary surplus by 2024.

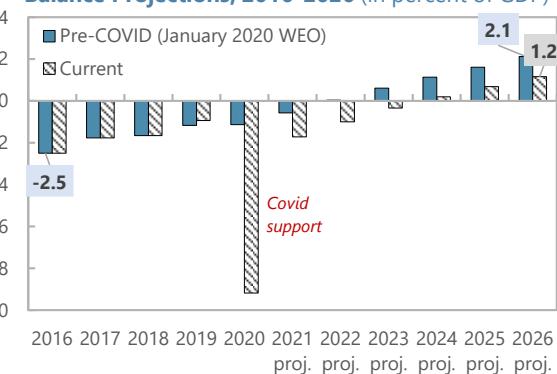
15. Gross public debt remains high, but the medium-term risk of sovereign stress is assessed as moderate (Box 6 and Annex IV). With a favorable interest-growth differential⁷ as well as BNDES debt repayments, NFPS gross debt will fall by 7 percentage points to 92 percent of GDP (IMF definition) in 2021. Over the medium-term, though, public debt is expected to level off around 92 percent of GDP and gross financing needs will remain high (around 20 percent of GDP), with the debt-GDP path sensitive to shifts in the outlook for interest rates, growth, and the primary balance. The federal government also faces risks from implicit and explicit legal⁸ and subnational contingent liabilities.



Brazil: NFPS Primary Expenditures, 2019-2022 (Percent of GDP)



Brazil: Pre- and Post-Pandemic NFPS Primary Balance Projections, 2016-2026 (in percent of GDP)



⁶ This mechanism applies to the Federal Government. A similar provision was added to facilitate fiscal consolidation at the subnational level. Albeit not compulsory, it is required if subnational governments wish to obtain Federal guarantees in credit operations. The provision is thus expected to bind for several states.

⁷ The boost to nominal GDP is significant from the sharp increase in the terms of trade.

⁸ The Supreme Court ruled that the base of the PIS/COFINS (federal tax) on the value of goods and services should not include the ICMS (state tax) and ordered the government to repay taxpayers the disputed amount as tax credits. The decision could reduce revenues by around 0.7 percent of GDP over the medium term.

Despite these vulnerabilities, debt is viewed as sustainable (Annex IV). There is an 80 percent probability that debt will either stabilize or decline over the medium-term (Box 6) and a drawdown of some of the government's liquid assets would further increase this probability. The Treasury has been nimble in adjusting debt management strategies, shortening maturities in the face of a steep yield curve in 2020, but taking advantage of improving market conditions in recent months and a deep domestic debt market to lengthen debt maturities. The government should aim to opportunistically lower debt by saving any windfalls from better revenue performance or stronger growth.

Brazil: Non-Financial Public Sector Operations under the New Fiscal Regime, 2016-2026 (percent of GDP)											
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Headline primary balance	-2.5	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2
<i>Headline consolidation since the expenditure rule was implemented 1/</i>		0.7	0.8	1.6	-6.7	0.8	1.5	2.1	2.7	3.2	3.7
Structural primary balance 2/	-1.4	-0.9	-1.2	-0.8	-7.7	-1.5	-0.9	-0.3	0.2	0.7	1.2
<i>Implied fiscal impulse 3/</i>		-0.5	0.3	-0.4	6.9	-6.2	-0.6	-0.6	-0.5	-0.5	-0.5
<i>Structural consolidation since the expenditure rule was implemented 4/</i>		0.5	0.2	0.6	-6.3	-0.1	0.5	1.1	1.6	2.1	2.6
Net interest expenditure	6.5	6.1	5.4	4.9	4.6	4.6	5.9	5.9	5.9	5.8	6.0
Gross debt	78.3	83.6	85.6	87.7	98.9	91.6	90.9	91.7	92.0	92.1	92.0
<i>Change from the previous year</i>		5.3	2.0	2.0	11.3	-7.3	-0.7	0.8	0.3	0.1	-0.1

Sources: National Treasury Secretary and IMF staff estimates
 1/ Difference between the headline primary balance in a given year and at end-2016 (moment when Congress enacted the expenditure ceiling rule).
 2/ In percent of potential GDP.
 3/ Measured as the opposite of the change in the structural primary balance (negative sign means fiscal loosening).
 4/ Difference between the structural primary balance in a given year and at end-2016 (moment when Congress enacted the expenditure ceiling rule).

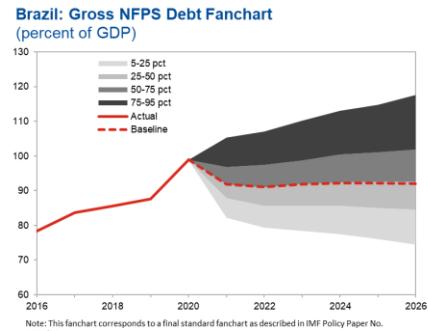
16. The new, more targeted COVID-19 spending will help boost household income and protect the most vulnerable while bolstering the economic recovery. Proposals to strengthen the social safety net, including revisiting the scope and coverage of Bolsa Família, will shape how poverty and income inequality will be addressed in the future. There is scope to consolidate various non-contributory cash benefit programs into one single program to reduce duplication and increase the progressivity of spending (potentially saving up to 0.7 percent of GDP). Such changes to these programs should aim to raise benefits and expand coverage for the most vulnerable.

Box 6. Summary of Sovereign Risk and Debt Sustainability Framework Results (SRDSF)

The SRDSF output complements results from the MAC DSA

	<i>Mechanical signal</i>	<i>Final assessment</i>	<i>Comments</i>
Medium term	Moderate	Moderate	The high debt level is assessed to be the main medium-term risk and requires fiscal consolidation. A deep domestic investor base, large liquid assets of the federal government and a low share of FX debt are mitigating factors, reducing short-term and rollover risks. In addition, around 25 percent of debt is held by the Central Bank, further reducing rollover risks.
GFN:	Moderate	Moderate	
<i>Fan chart:</i>	Moderate	Moderate	

Medium-Term Stress Signal: Despite the high debt level and wide distribution of historical shocks, debt has a high probability of stabilizing by 2026 and risks of sovereign stress are viewed as moderate. The level of gross financing needs is relatively high but the availability of liquid assets and the ability of domestic financial institutions to absorb higher issuances in a stress scenario result in medium-term financing risks being judged as moderate.



17. Federal tax expenditures should be scaled back. The emergency constitutional amendment requires the authorities to submit to Congress a plan to reduce tax expenditures from 4.2 to 2 percent of GDP over 8 years, although a quicker reduction would frontload the benefits to equity and efficiency. Tax reform should aim to increase progressivity, reduce the misallocation of resources, and raise potential growth (Box 7).

- *Federal VAT:* The government's proposal to unify the PIS and COFINS into a federal VAT (CBS) at a non-cumulative 12 percent rate represents a step forward and, if approved, would eliminate about 0.3 percent of GDP in tax expenditures. Eliminating preferential rates and credits on food and medicine could yield another $\frac{1}{4}$ percent of GDP in revenues which could be deployed to increase social transfers to vulnerable households.
- *Income tax reforms:* The government's proposal is currently expected to be net revenue losing, but includes some welcome measures to reintroduce dividend taxation, eliminate interest payments on net equity deductions from the corporate income tax (CIT), and tax accrued capital gains in closed-end investment funds. These changes will partially offset revenue losses from increasing the personal income tax (PIT) exemption threshold by 31 percent and lowering the CIT rate by $1\frac{1}{2}$ percentage points to $2\frac{1}{2}$ percent. The reform could, however, go further in addressing PIT and payroll tax exemptions, taking steps to reduce base erosion and profit shifting, as well as scaling back generous provisions for SMEs and specific regions (e.g. the Simples Nacional and the Manaus Free Zone) which cost up to $2\frac{1}{4}$ percent of GDP in foregone revenue. Furthermore, the proposed $1\frac{1}{2}$ percentage points reduction in the statutory CIT rate should ideally be considered alongside more ambitious base broadening measures (especially regarding the special SME regimes).

18. Budget rigidities are preventing the government from improving the composition of spending and reducing fiscal policy's ability to respond to shocks. Almost 93 percent of federal primary expenditures are mandatory in the 2021 budget (heavily concentrated in pensions and wages). Discretionary spending (mostly public investment and the provision of essential public services) is small and was further compressed in the 2021 budget. The small amount of discretionary spending hampers the ability of the government to cope with shocks and can lead to protracted budget negotiations that are damaging to market sentiment (as seen during the 2021 budget process). To address these issues, the authorities should scale back the share of mandatory outlays. An administrative reform that reduces personnel costs by overhauling civil service career structures and aligning public compensation with the private sector,⁹ and de-indexing spending, including those items linked to the minimum wage, would help. At the subnational level, current minimum requirements for spending on education and health impose rigidities that prevent the legislature from optimizing the allocation of budgetary resources. There is room for efficiency improvements without compromising the coverage and quality of service provided. In this regard, rolling spending reviews of large budgetary programs would help.

19. Developing a comprehensive medium-term fiscal framework with clear targets and specific measures to achieve them would further support fiscal credibility. The expenditure ceiling has worked well to contain expenditure growth and support market confidence. However, the authorities have relied on specific legislative actions, rather than formal escape clauses, to accommodate emergency spending. This approach may undermine the predictability of the fiscal framework with implications for market confidence. A strengthened medium-term framework could supplement the expenditure rule with an explicit debt anchor and specific escape clauses that narrowly define the conditions for suspending the fiscal rules.¹⁰ The framework should include well-defined corrective mechanisms to ensure the consolidation path is resumed once the emergency conditions have abated. Scenario analysis should also be embedded in the framework to help the authorities undertake contingency planning.

20. Subnational finances remain in a structurally difficult position. Despite recent primary surpluses and the stronger-than-expected tax revenues in 2021, subnational governments continue to pose sizeable fiscal risks. Subnational authorities should rebuild buffers, improve the quality of subnational fiscal reporting (as required by the Fiscal Responsibility Law), and adopt more conservative debt limits. To reduce moral hazard, subnational fiscal frameworks should impose credible, hard-budget constraints and there should be strict limits on federal government support. The introduction of subnational primary spending caps, balanced budget rules, and the building-up

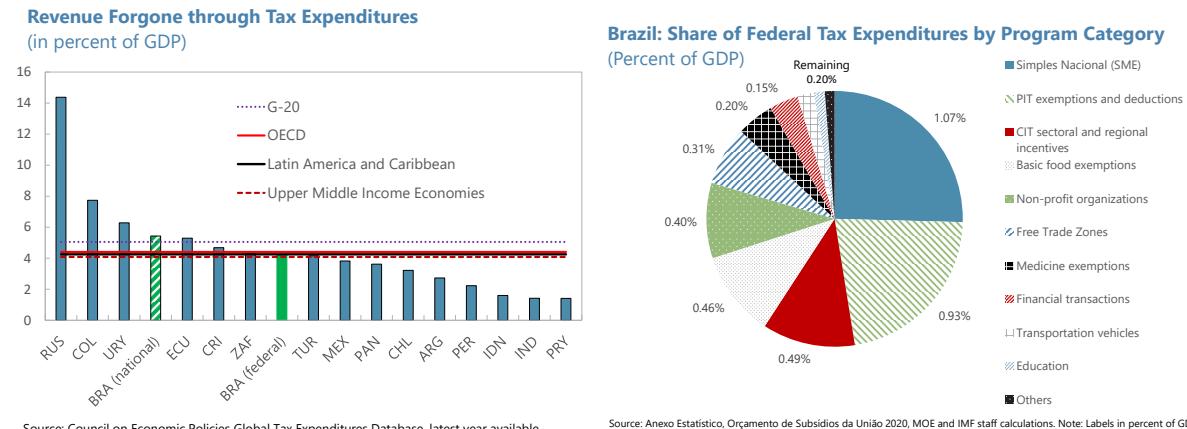
⁹Wage, hiring, and promotion freeze, with a hard cap on total remuneration per employee, and allowing wage cuts in proportion to cuts in working hours, could save up to one percent of GDP per year in personnel costs (see IMF Country Report 20/311).

¹⁰In particular, the upgraded escape clauses could usefully specify the duration and the activation procedures to avoid political pressures of imprudent spending on low-priority areas or over-using the escape clauses (Gbohoui and Medas 2020). An independent fiscal council could provide direct inputs to the budget process and monitor compliance with fiscal rules while fostering fiscal transparency. The Independent Fiscal Institution (IFI) could play this role but doing so would require further strengthening its legal independence, providing greater clarity about the scope of its mandates, and ensuring that it has sufficient resources to carry out any new responsibilities.

of rainy-day funds would all help reduce fiscal vulnerabilities. Finally, while a few states have made progress, many have yet to reform their subnational pension systems to align them with the new provisions for federal government employees.

Box 7. Tax Expenditure Rationalization within Broader Tax Reform

Tax expenditures have proliferated in Brazil over the past two decades. To compensate for a relatively high overall tax burden, a complex set of federal and subnational tax expenditures have proliferated in many sectors, costing the general government over 5 percent of GDP per year. These policies add to the complexity and regressivity of Brazil's tax system, exacerbate geographic disparities, and offer little evidence of a positive impact on productivity, investment, or employment. Many of the tax expenditures benefit the rich.



Source: Council on Economic Policies Global Tax Expenditures Database, latest year available.

Source: Anexo Estatístico, Orçamento de Subsídios da União 2020, MOE and IMF staff calculations. Note: Labels in percent of GDP.

Eliminating tax expenditures should be incorporated into a comprehensive tax reform involving all levels of government. Significant welfare gains could be achieved by:

- Aligning the integrated CIT rate with the top marginal PIT rate to lessen the incentives for individual taxpayers to incorporate to reduce their tax obligations. With a lower CIT rate of 21½-29 percent, this would imply that dividends would be taxed at around 15 percent. This could be combined with an allowance (i.e., a deduction from the base) for corporate equity, applying only to new equity increases and without requiring the distribution of corporate profits to shareholders.
- Expanding transfer pricing regulations relating to thin capitalization to debt service expenses between unrelated domestic and foreign non-low-tax parties, for example, by capping deductible interest expenses to a percentage of EBITDA, with financial institutions excluded.
- Lowering the eligibility threshold for the simplified tax regime for smaller firms (Simples Nacional) to BRL 1 million, excluding social security contributions from the list of waived taxes, barring professionals from the scheme, and eliminating the redundant and often distortionary "presumptive profit" regime.
- Eliminating most PIT deductions and capital income exemptions (e.g. related to pension income, savings vehicles, and personal health and education expenses).
- Reducing payroll taxes while raising the top PIT rate to 30 percent.
- Strengthening the coverage of property and inheritance taxes.
- Replacing various indirect taxes with a uniform value-added tax (VAT) and excises on specific products. Preferential treatment or zero-rating for certain domestically consumed goods would be eliminated (alongside an expansion in social transfers to compensate lower income households).

Authorities' Views

21. The authorities reiterated their firm commitment to the expenditure rule. They highlighted that new mechanisms (triggers) approved in the emergency constitutional amendment will help to contain the growth of mandatory expenditures at both Federal and subnational levels, and the new "state of calamity" escape clause will enable better contingency planning and the quick deployment of fiscal support in future crises. They explained that the 2021 budget process was delayed by difficult negotiations with Congress and inflation surprises that required adjustments to the draft budget law that was released in August 2020. The authorities concurred with staff that reviewing the consistency among existing fiscal rules would help to enhance the transparency and credibility of Brazil's fiscal framework.

22. The authorities plan to move expeditiously on tax reforms. Although the intended reforms have been broadly revenue neutral, they would entail substantial gains to the business environment, equity, and efficiency of the tax system. The authorities originally estimated that revenue loss from lower CIT rates and higher PIT thresholds would be exactly offset by yields from dividend taxes, repeal of allowances for corporate equity, and taxation of accrued capital gains in some types of investment funds that have been exempt until now. However, they now anticipate the larger than initially proposed CIT rate cut will entail a net revenue loss in the order of 0.4 percent of GDP, to be compensated by structurally higher tax revenue collection across all federal taxes. They expect that the replacement of PIS/COFINS with a new tax (CBS) will address prospective revenue losses associated with the Supreme Court decision regarding the exclusion of the state tax ICMS and some tax expenditures related to PIS/COFINS. They recognize the ineffectiveness and regressivity of several special tax regimes currently in place and are committed to send to Congress a plan for the gradual rationalization of tax expenditures, reducing them to 2 percent of GDP.

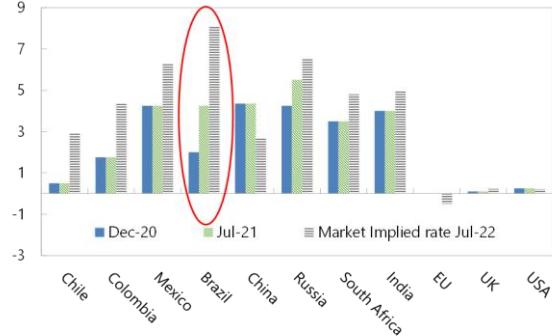
23. The authorities pointed to decreased debt sustainability risks. They see their large cash deposits as a key buffer which they plan to maintain in the medium-term. In addition, the cash deposits were further bolstered by the 2021 emergency constitutional amendment, which freed up surpluses from specific public funds (about 2 percent of GDP) for debt management purposes. The authorities are committed to lengthening the maturity and composition of debt issuances in line with the strategy presented in their latest borrowing plan. The authorities also agreed with staff that subnational finances remain under stress and supported staff's proposed reforms.

B. Difficult Monetary Policy Trade-Offs

24. A steady monetary tightening is needed to guide inflation back to target by end-2022. The accommodative stance was important in facilitating a stronger-than-expected recovery in 2020. However, with rising inflation and the risk of de-anchoring inflation expectations, the current pace of tightening will likely need to be maintained for the remainder of the year. Doing so would bring the policy rate to the neutral level by end-year. This is expected to help anchor inflation expectations and guide inflation back to the mid-point of the target range by end-2022. However, policy should remain data dependent. If wage and non-tradable price pressures build—neither of which is currently evident in the data—a faster increase in the policy rate may be needed. On the other hand,

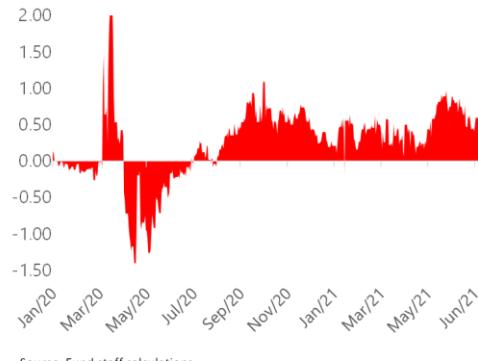
if inflation pressures diminish sooner, there could be scope to reduce the pace of policy rate hikes. In either case, careful attention should be paid to the behavior of inflation expectations at an 18–24-month horizon. Policy should ensure those expectations remain solidly anchored at the mid-point of the target range.

Policy Rate for Brazil and Selected Countries (in percent)



Sources: Bloomberg and IMF staff calculations.

2Y Break-Even Inflation Term Premium



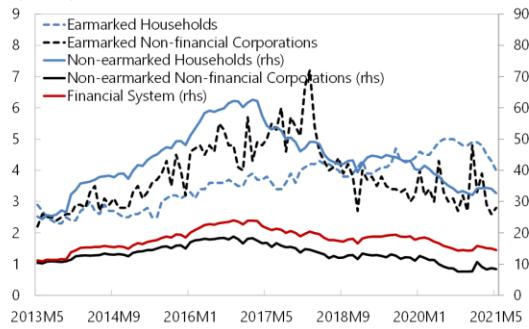
Source: Fund staff calculations.

25. Concerns about the path of the pandemic, fiscal risks, or uncertainties surrounding the political calendar could weigh on the exchange rate and pass-through to inflation. To counter such an inflationary impulse would potentially necessitate a sharp increase in the policy rate. In such a scenario, FX intervention should be limited to countering disorderly market conditions. A strong commitment to the fiscal framework and assertively addressing the risks posed by the pandemic would, however, lessen the likelihood that such policies will need to be deployed.

26. The BCB's active communication and move toward greater transparency in the COPOM statements is commendable. The use of forward guidance in the BCB's communications, and its explicit commitment to the inflation target, has helped keep medium-term inflation expectations anchored. Given the uncertainty around the outlook, the BCB should continue to provide clear forward guidance that is linked to economic outcomes as well as articulating the timeline and pace at which the BCB's inflation goal is expected to be reached.

27. Approval of de jure central bank independence, new liquidity facilities, and the introduction of voluntary deposits will strengthen the BCB's ability to deliver on its mandate. The Central Bank autonomy bill addresses important FSAP recommendations (Annex V). It introduces fixed, four-year mandates for BCB governors (that are staggered relative to the presidential term), and requires Senate approval for their dismissal. Smoothing business cycle fluctuations, promoting full employment, and promoting financial system stability and efficiency have become explicit mandates for the BCB (albeit secondary to price stability). Future legislative changes could usefully prioritize legal protections for central bank staff. The launch of two new

Spreads (Percent)



Sources: BCB, CEIC and Fund staff calculations.

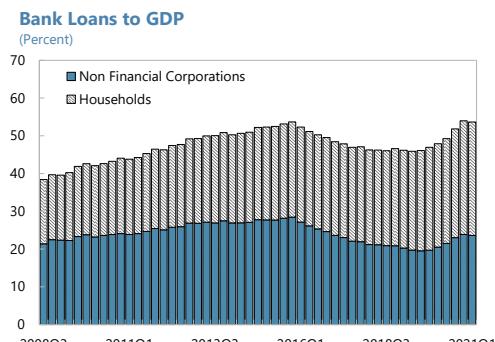
liquidity facilities will improve financial institutions' access to liquidity, facilitating a structural reduction of required reserves and lower the deposit-loan spread.¹¹ The introduction of voluntary deposits at the BCB as a new monetary policy tool is in line with the practice in many advanced economies and should increase the BCB's flexibility in managing liquidity.

Authorities' Views

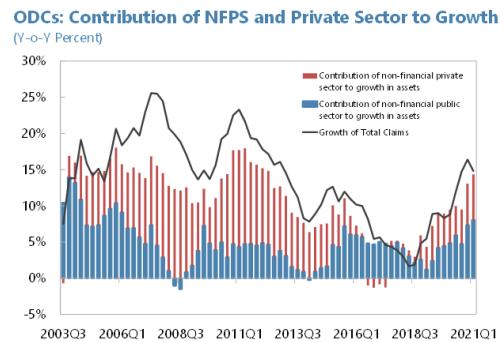
28. The BCB is confident that the current tightening cycle will lead inflation back to target by end-2022. The Central Bank considers its proactive rate increase as necessary given the strong economic recovery and inflation pressures that are more persistent than initially expected. Taking monetary policy to a neutral stance will ensure meeting the inflation target at the relevant horizon. The Central Bank emphasized the importance of separating policy tools, with the policy rate used to control inflation while the exclusive goal of FXI is to correct dysfunctional FX market conditions. The authorities view approval of Central Bank autonomy as a crucial step for Brazil's monetary policy framework.

C. Fostering Financial Competition and Inclusion

29. The financial system has remained resilient and real credit growth is supporting the recovery. NPLs remained low at 2.2 percent in 2020Q4, partly due to the restructuring of loans and to debt moratoria. While a third of the outstanding credit portfolio were modified, 52 percent of the modified¹² portfolio have resumed standard payments. Banks have increased their provisions in preparation for an anticipated rise in NPLs once support measures are phased out. Provisions for modified loans were 9.4 percent in December 2020, while provisions for non-modified loans reached 4.5 percent. Despite this provisioning, bank profitability remains high and capital buffers are adequate. A surge in household and corporate cash deposits during the pandemic has increased liquidity buffers. Credit growth exceeded 10 percent for both households and corporates in 2020, driven by rebounding consumption and investment as well as government credit incentive programs (Figure 6).



Sources: CEIC and Fund staff calculations.



Sources: CEIC and Fund staff calculations.

¹¹ The facilities will accept corporate bonds and commercial paper (with appropriate haircuts) as collateral. The launch is set for 2021Q3.

¹² Modified loans include loans with payment deferrals, maturity date postponement, duration increase, and restructured debt.

30. Staff's stress tests suggest that the banking system can withstand a severe adverse shock (Box 8). Capital and liquidity buffers are adequate, and if needed, banks could draw down their capital conservation buffers and their stock of High-Quality Liquid Assets, allowing the Liquidity Coverage Ratio to temporarily fall below 100 percent. Losses on modified loans have been lower than expected and the precautionary increase in provisions in anticipation of a gradual withdrawal of support measures appears sufficient. The elimination of the tax asymmetry between investments abroad and their corresponding FX hedges has reduced banks' incentive to "over-hedge" FX risks and lessened banks' vulnerability to currency depreciation. Nevertheless, banks' elevated exposure to public debt poses risks and bank-sovereign linkages should be closely monitored.

31. The BCB continues to promote financial sector efficiency and inclusion. The instant electronic payment system (PIX) introduced in November was used by approximately 80 million individuals within the first eight months of its launch (17 million of whom had not previously made electronic transactions). The average transaction amount using PIX has also been lower than for other electronic payment methods. The step-wise introduction of open banking in 2021 increases the sharing of customer data between financial institutions and will increase competition in financial intermediation. Two thirds of individuals registered in the credit database¹³ (Cadastro Positivo) had their credit scores changed¹⁴ and analysis from the BCB suggests the database has led to a 10.3 percent reduction in borrowing costs on non-payroll loans.¹⁵ Efforts are also underway to strengthen financial education.

Authorities' Views

32. The authorities share staff's assessment that the banking system is resilient to adverse shocks. The BCB considers risks associated with the financial systems' exposure to sovereign debt to be contained and expect the banks' FX "over-hedge" to disappear by the end of the year. They expect PIX and open banking to continue to foster competition, reduce costs of financial services and increase financial inclusion, and will publish a report on financial citizenship in October that highlights the progress made thus far.

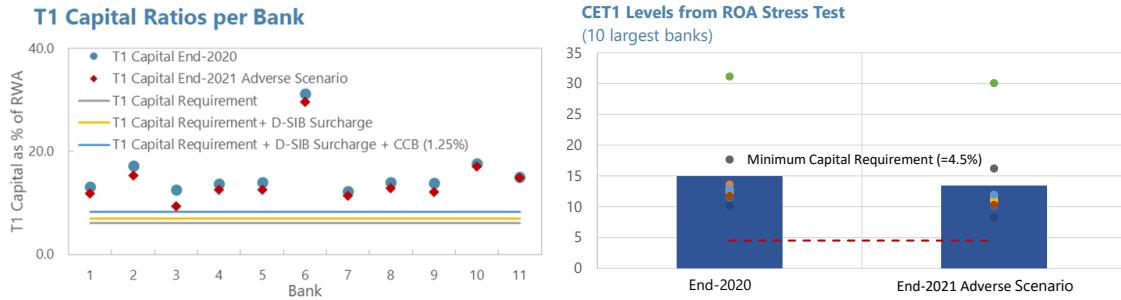
¹³ The credit database was launched in 2011 but had a 15-fold increase in its registered individuals in November 2019 when the default setting was changed from opt-in to opt-out.

¹⁴ Approximately 41 percent migrated to lower risk categories, while 26 percent migrated to higher risk categories.

¹⁵ See "[Análise dos efeitos do Cadastro Positivo](#)", Banco Central do Brasil, April 2021.

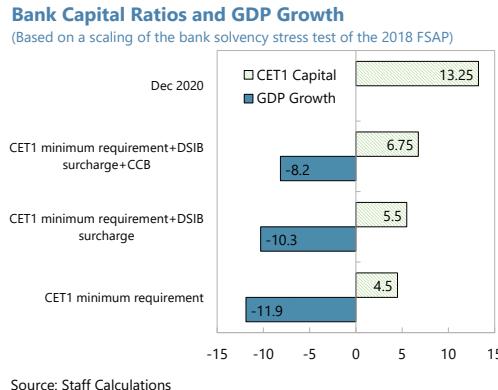
Box 8: Bank Stress Test Results

This box presents the results of stress tests performed by staff using three different methodologies. The results are corroborated by stress tests presented in the BCB's April 2021 Financial Stability Report. Under a stressed scenario—in which output contracts by 4 percent, unemployment increases by 6 percentage points, and the currency depreciates by 35 percent—NPLs would rise to about 5 percent (although the restructuring of loans and the debt moratoria introduced during the pandemic may lessen these effects). The rise in NPLs would cause the average Tier 1 capital ratio to fall from 13.8 percent to 11.8 percent (still well above the regulatory minimum even when including the surcharge for domestic systemically important banks (D-SIBs) and the full capital conservation buffer).¹ The 11 largest banks would all remain above a 10 percent Tier 1 capital ratio.



The return-on-asset (ROA) based stress test shows that all banks can maintain their CET1 capital ratios above the 4.5 percent minimum even without steps to reduce dividend payments, lower the capital conservation buffer, or exempt restructured loans from provisioning.

A scaling of the 2018 FSAP stress test using relative GDP growth suggests that GDP would have to fall by more than 8 percent for the average Common Equity Tier-1 level to reach the regulatory minimum. Even in such an extreme tail risk scenario, the capital shortfall for individual banks would be relatively small if, as is likely, supervisors direct banks to suspend dividend payouts and draw on their capital conservation buffer.



¹ Because NPLs in Brazil are written off within one year, the historical series show little variation and stress tests based on the modelling of NPLs, become less reliable. To compensate for this, we complement our analysis by looking at provisions, basing one of the stress tests on the return on assets and scaling the FSAP stress test results.

D. Steps to Boost Potential Growth

33. Despite the pandemic, the authorities have pressed ahead with institutional reforms, in line with past staff advice (Annex VI). Central bank autonomy was approved, improvements were made to the efficiency and inclusiveness in the financial sector, and the emergency constitutional amendment introduced new mechanisms to control mandatory spending growth. Discussions on the creation of a federal VAT and administrative reform are ongoing in Congress and the government has submitted legislation to improve the progressivity of the income tax system. New laws on sanitation, startups, natural gas, and bankruptcy have also been introduced along with steps to privatize *Eletrobras* (Box 9), measures that staff support. To increase competition in tradable

goods, import tariffs were reduced by 10 percent for 1,495 products, and all import tariffs below 2 percent were reduced to zero.

34. Steady progress in supply side reforms would support a more competitive economy and help raise living standards. Brazil has long suffered from stagnant productivity (Box 10).

Recent reforms have already attracted private investment of US\$8.3 billion (0.6 percent of GDP) into sectors such as transportation, energy, and water and sewage in 2020, and are expected to generate additional infrastructure investment going forward. The 2020 OECD Economic Survey of Brazil estimates that further reforms to improve domestic regulation and competition, reduce barriers to foreign trade, and improve institutions and economic governance could boost annual per-capita GDP growth by 0.9 percentage points over 15 years. Priority should be given to further easing the stringency and complexity of market regulations, reducing barriers to entry in network sectors, and further liberalizing trade by reducing tariff and non-tariff barriers. Policies to reduce labor market rigidities and facilitate reallocation across industries would help address COVID-induced dislocation but they could entail short-term cost. Vocational and adult training programs could help workers adapt to the evolving demand for skills while improving governance would reduce the costs of investing in Brazil and provide a more predictable environment for businesses.

Box 9. The Government's Supply-Side Reform Plans

The government has developed an ambitious reform agenda around three main pillars. This box summarizes the accomplishments in each area (✓) and the agenda that remain to be implemented (►), based on the government's own classification and progress assessment.

Improve the business environment to reduce the cost of doing business in Brazil by R\$1 trillion; increase the productivity of SMEs; and reach the top 50 countries in the World Bank Doing Business ranking.

- ✓ Law of Economic Freedom, Path to Deregulation, PEAC, PRONAMPE, Bankruptcy Law, Unified Channel for SMEs, SME Advocacy, New *Ex-Tarifário*, FIARC, Credit Score, Extraordinary Credit Law, Reduction of Labor Bureaucracy, and Regulatory Impact Assessment (AIR).
- Doing Business Law, Environmental Licensing Law, Bankruptcy Law for SMEs, Maximum Efficiency, Legal Safety Law, Microcredit Law, The Green Amazon Project, National Guarantees System, Law of Professional Freedom, *Tiradentes Act*, and New Simples.

Foster private investment attracting R\$107 billion per year in private investment in infrastructure; and reaching the OECD average ranking for product market reforms in 2 years.

- ✓ Sanitation Law, Telecommunications Law, Economic Evaluation Projects (CBA), Pro Health -Phase 1, Pro Fuel-Phase 1, FUST Law, Natural gas law, SEZ Law.
- Pro-land, Infrastructure Bonds, Cabotage Law, Electricity Law, Railway Law, Concessions and PPP law, Public Land for Affordable Housing, Civil Construction Law, Private Health Law, and Law of Capital Market.

Catalyze a productive and digital future, increasing the digital maturity of the productive sector by 20 percent; reaching the top 3 worldwide in startups; and acquiring 10 million workers that are qualified in soft skills.

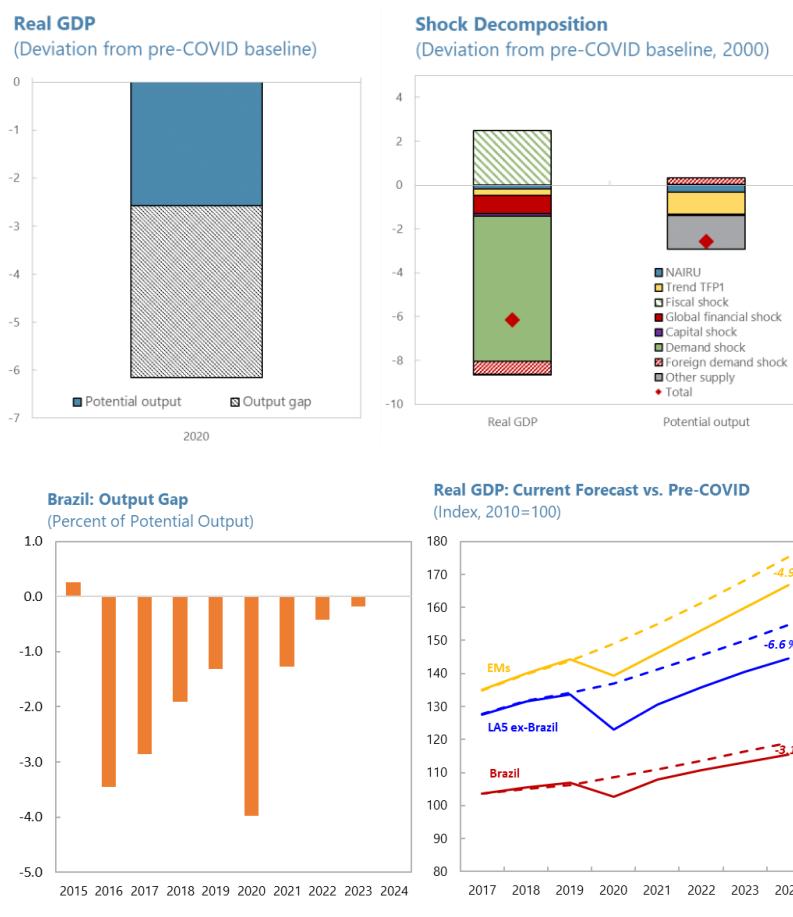
- ✓ Startup Law, Brazil +, 15K Innovative, World-class IP, Job Skill Project, New SINE Project, 4.0 Economy, New Lei de Informática, Digitalize Brazil.
- New *Lei do Bem*, and Professional Education Law.

Box 10. Assessing the Effects of COVID-19 on Potential Output

The G20 module of the Flexible System of Global Models was used to simulate the impact of the COVID-19 shock on potential output. Supply shocks were introduced from lower TFP and capital stock, higher NAIRU, and a shift in global financial conditions. Demand shocks originate from the domestic economy and from the main trading partners. The model differentiates between:

- A severe shutdown (where all non-essential services are closed through a shelter-in-place order);
- A moderate shutdown (as measures are loosened up or become more targeted); and
- A post-shutdown (where businesses are allowed to reopen but social distancing remain in place).

The model suggests that about 40 percent of the contraction in 2020 GDP arose as a result of a decline in potential GDP (of around 2.6 percent from the pre-COVID baseline) and 60 percent came from a widening of the output gap (which rose to around 4 percent). The level of output is expected to remain about 3 percent below the pre-COVID trend due to hysteresis in labor force participation and the pandemic's effects on human and physical capital accumulation.



Sources: IMF World Economic Outlook and Fund staff calculations.

35. Strengthening the effectiveness of anticorruption and AML/CFT frameworks will help support investment. On-going transparency and open data initiatives as well as the government's Anticorruption Action Plan are welcome steps. However, asset declarations of high-level public officials should be made accessible to the public, the regimes to handle conflict of interest for public officials should be strengthened, and illicit enrichment should be criminalized in line with international best practices. There is a need also to protect the independence of, and ensure a stable

operating framework for, anti-corruption and AML/CFT institutions. The termination of task forces to investigate complex cases, legislative amendments that could change prosecutors' investigative powers, or reversals in legal precedents could weaken the fight against corruption. The executive, legislative, and judiciary should ensure a predictable framework for fighting and adjudicating corruption and financial crimes, prioritizing its effectiveness and continuity, and enhancing the capacity of relevant agencies. The recent finalization of the AML/CFT national risk assessment, alongside efforts to disseminate its findings, is commendable. Further steps will be needed to enhance the availability and access to beneficial ownership information and to bolster the AML/CFT supervision of real estate agents, lawyers and accountants, and virtual assets service providers. Finally, transparency and accountability measures to prevent misuse of COVID spending are welcome steps but further efforts are needed to ensure their implementation at the state level, including in relation to procurement transparency.

36. The authorities are developing policies to promote environmentally sustainable activities. Brazil is a key commodity producer and exporter and, therefore, potentially more frequent disruptive weather events (e.g., droughts and floods) may generate important adverse effects. In addition, electricity generation is highly reliant on hydropower and, as a result, also impacted by such weather events. To respond to these and other climate-related risks, the government is undertaking several initiatives (Box 11), including strengthening incentives for privately led conservation activities in agriculture, fostering the development of green public and corporate bond markets, and improving the integration of Environmental, Social, and Governance (ESG) criteria in the evaluation of infrastructure projects. The BCB has added to its BC# agenda a sustainability pillar to promote "green" financing, including a "green liquidity facility" (that would accept certain climate bonds as collateral), and is among the first central banks to quantify social, environmental, and climate-related risks in the financial sector.

Box 11. Climate Change Mitigation Targets and Selected Economic Policy Initiatives

Nationally Determined Contribution (NDC) under the Paris Agreement	Updated in 2020 the NDC: (i) pledges to cut net greenhouse gas emissions by 37% and 43% by 2025 and 2030, respectively; (ii) introduces an indicative target of carbon neutrality by 2060 (updated to 2050 at the April 2021 Climate Summit).
Environment and Carbon Taxes	Environmental law includes "polluter-pays" principle applied in water-use and waste management, nature conservation and other specific policies. Some fuels are subject to excise taxes but there is no carbon tax.
Promotion of Green Finance¹	The BCB 'Sustainability' Pillar includes: <ul style="list-style-type: none"> • Creating a sustainable liquidity facility. • Including sustainability criteria for the selection of counterparties and investments of international reserves. • Publishing analysis on the effects of climate change on the banking sector. • Structuring and expanding the collection of information on socio-environmental risks.

**Box 11. Climate Change Mitigation Targets and Selected Economic Policy Initiatives
(concluded)**

- Improving regulation on socio-environmental risks.
- Improving information disclosure by FIs, based on the recommendations of the taskforce on climate-related financial disclosures
- Improving sustainability criteria on rural credit operations (and the creation of the ‘Green Bureau’ for rural credit)
- Including climate risk scenarios in new and improved stress tests
- Publishing the BCB’s Report on Social, Environmental and Climate Risks and Opportunities

New (2020) regulation allowing fast-tracking of green infrastructure bond issuance (previously only for renewable energy projects).

2021/22 *Plano Safra* (subsidized rural credit program) doubled the amount of funds to be channeled to sustainable agriculture (to BRL 5 billion).

**Incentives for Use of Renewables,
Conservation Activities**

Tax incentives for investments in solar or wind energy as well as biofuels production; creation of a “decarbonization credits” market²; new framework for environmental services’ payments (including through sale of green bonds).

**Public Infrastructure Projects –
Greener Planning**

Standardized appraisal of carbon/deforestation shadow costs; centralized guidance to private investors on environmental impact assessments and licensing.

Changes in Land Use practices

Low Carbon Agriculture Plan (*Plano ABC*) promotes mitigation and adaptation in the sector. The ABC Plan consists of seven programs, six of which refer to mitigation technologies, and a final program with actions to adapt to climate change:

- Program 1: Recovery of Degraded Pastures.
- Program 2: Crop-Livestock-Forest Integration (iLPF) and Agroforestry Systems (SAFs).
- Program 3: Direct Planting System (SPD).
- Program 4: Biological Nitrogen Fixation (FBN).
- Program 5: Planted Forests.
- Program 6: Animal Waste Treatment.
- Program 7: Adaptation to Climate.

¹ In addition, the government directly supports climate mitigation and adaptation projects through its development bank (BNDES) and various environment-related funds.

² “Decarbonization credits” are certificates sold by certified biofuel producers, traded in the Brazilian stock exchange. Buyers (fuel producers) can use them to meet mandatory decarbonization targets.

Authorities' Views**37. The authorities concurred with staff's emphasis on institutional reforms to boost potential growth.**

- The government is optimistic about its pro-market reform agenda, noting that it is changing culture and gaining traction with Congress. The authorities hailed recent legislative milestones aimed at improving the business environment in Brazil, attract private investment, and enhance productivity and competition, while acknowledging scope for further advances in reducing red tape and streamlining the tax system. They indicated that full implementation of their reform agenda would result in a real GDP level 4-8 percent higher over the next 10 years. Under their current plans, the authorities expect to reach the OECD average ranking in product market reforms in two years.
- The authorities highlighted recent AML/CFT achievements, such as the finalization of the AML/CFT national risk assessment and the implementation of new regulations for the supervision of banks. While the date of the AML/CFT mutual evaluation had been postponed due to the pandemic, they are committed to continue strengthening the effectiveness of the AML/CFT framework in line with FATF standards. With respect to anticorruption, the authorities pointed to enhanced transparency and monitoring measures such as those related to the disbursement of COVID-19 emergency aid. In addition, they highlighted the stable operating framework for anti-corruption institutions, based on legal mechanisms to guarantee the independence of all agencies involved, including the functional and financial independence of the Public Prosecutor's Office anchored in the Constitution. Recent measures are seen as contributing to strengthen the fight against corruption. Furthermore, the authorities discussed the commitments under the Federal Government's Anticorruption Plan, which include the review of the current regulation on beneficial ownership to intensify the validation and consolidation of information, and the proposal of a new regulation to ensure transparency on the final beneficiaries of companies receiving public funds, both to be fulfilled by December 2023. Moreover, they stressed the country's progress in the implementation of the BEPS (Base Erosion and Profit Shifting) action plan. Overall, the authorities see the framework for fighting corruption and financial crimes as predictable and effective. The authorities also clarified that the income of public officials is published on the transparency portal website and that their asset declarations are made available to all responsible oversight institutions. Regimes to handle conflict of interest for public officials are enforced by law and provide for the penalty of dismissal and criminal sanctions.

STAFF APPRAISAL

38. Despite a surge in COVID-19 cases earlier in the year, economic performance has been better than expected. Targeted spending to support vulnerable households in 2021 is welcome and is supporting a strong cyclical recovery which has raised output back to pre-pandemic levels. Gross public debt as a share of GDP will fall sharply in 2021, reversing more than two-thirds of the debt accumulated during the pandemic. Market sentiment has improved with the decline in near-term fiscal risks. Important institutional reforms—including the central bank autonomy law and the privatization of *Eletrobras*—have been approved.

39. Policy makers will need to remain alert while sustained progress with institutional reforms will help bolster market confidence. A weak currency and a surge in commodity prices have fed into headline inflation and inflation expectations even as the output gap remains negative. The labor market is lagging the recovery in output, and the unemployment rate is high, especially among youths, women, and afro-Brazilians. Cash transfers will eventually expire and, in the absence of a permanent strengthening of the social safety net, poverty and inequality could become more acute. Near term fiscal risks are low, but the high level of public debt continues to pose medium-term risks. Restoring high and sustained growth, increasing employment, raising productivity, improving living standards, and reducing vulnerabilities will require policy efforts to eliminate bottlenecks and foster private sector-led investment.

40. Fiscal policies should focus on rebuilding buffers, reducing budget rigidities, and addressing fiscal imbalances. Fiscal space is at risk. The expenditure rule has played a critical role in maintaining market confidence, and its adherence will continue to be necessary to bring down public debt over the medium term. Reducing budget rigidities and mandatory spending will create greater space for public investment and a stronger social safety net. Consolidating social safety net programs could help free up resources to target support better toward the poor. An ambitious reduction of tax expenditures within a broad tax reform package would help improve compliance, increase progressivity, reduce resource misallocation, and boost potential growth. The ongoing tax reform discussions in Congress provide opportune timing for such needed rationalization. A more robust medium-term fiscal framework would enhance fiscal credibility and strengthen subnational finances will reduce fiscal risks and improve their capacity to manage adverse shocks.

41. A continued increase in the policy rate will be needed to guide inflation back to target by end-2022. Given the uncertainty around the outlook, policy would need to be data dependent, with careful attention given to the behavior of inflation expectations at the relevant policy horizon. The BCB has been active in communicating its outlook and policy goals and should continue to provide clear forward guidance on the likely future course of monetary policy. In the event that concerns about the path of the pandemic, fiscal risks, and/or uncertainties surrounding the political calendar lead to currency depreciation, the central bank would have to respond forcefully, potentially with a sharp increase in the policy rate to limit the pass-through to inflation. FX intervention should be limited to countering disorderly market conditions.

42. A gradual phasing out of crisis-related financial support is appropriate and continued efforts should be made to improve the quality and efficiency of financial intermediation.

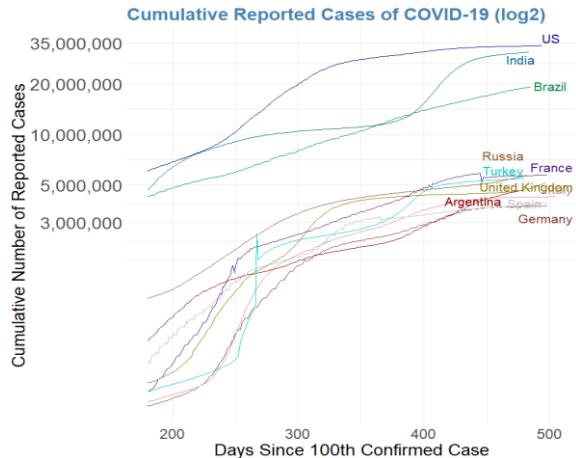
Liquidity support from the BCB together with carefully designed debt moratoria have helped the banking sector maintain credit supply through the pandemic, providing support to the recovery. Stress tests suggest that the banking system can withstand substantial shocks by using available buffers. The introduction of new BCB liquidity facilities will be especially useful for smaller banks with lower access to market liquidity and should facilitate a reduction in required reserves. The instant electronic payment system and introduction of open banking will help increase financial inclusion and reduce credit risk.

43. The authorities have an ambitious supply side agenda. Recent reforms should increase private investment and reduce the infrastructure gap. Boosting productivity will require concerted action to liberalize trade (scaling back both tariff and non-tariff barriers) and product markets, increase the flexibility of labor markets and reduce informality, simplify the tax system, and improve governance. The authorities should continue to strengthen the effectiveness and predictability of the anticorruption and AML/CFT frameworks, prioritize institutional independence to fight corruption and financial crimes, and improve the environment for private investment.

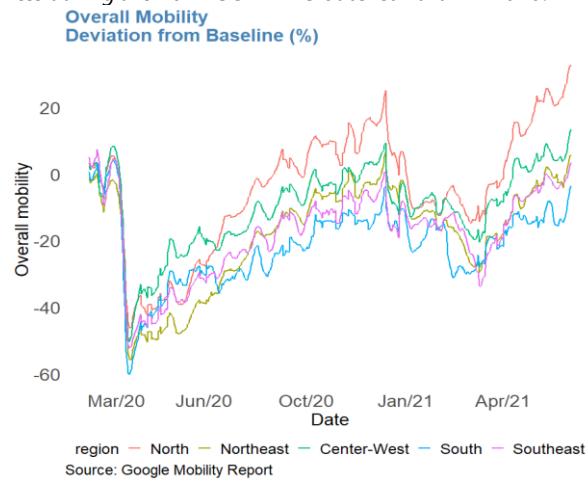
44. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Brazil: COVID-19 Health Indicators

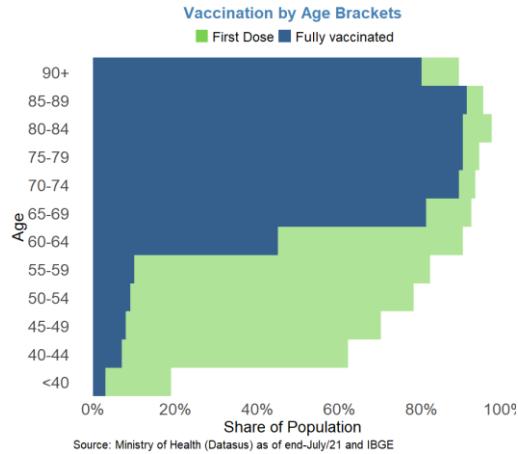
Brazil recorded the third highest number of COVID-19 cases in the world...



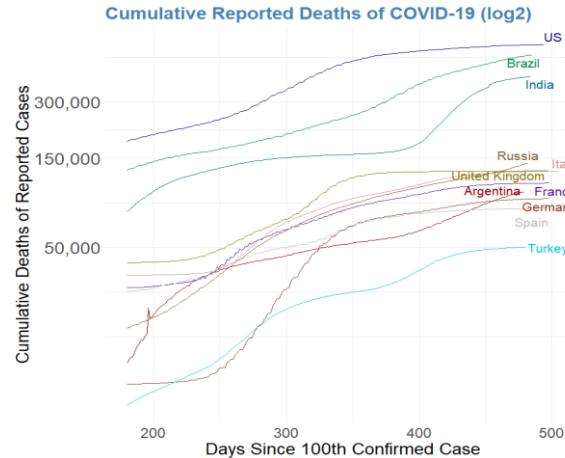
Despite new lockdowns, social mobility declined by much less during the 2021 COVID-19 outbreak than in 2020.



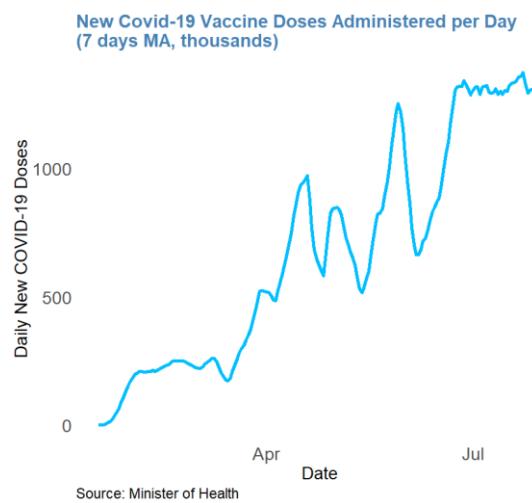
... with a sizable percentage of key age groups fully vaccinated.



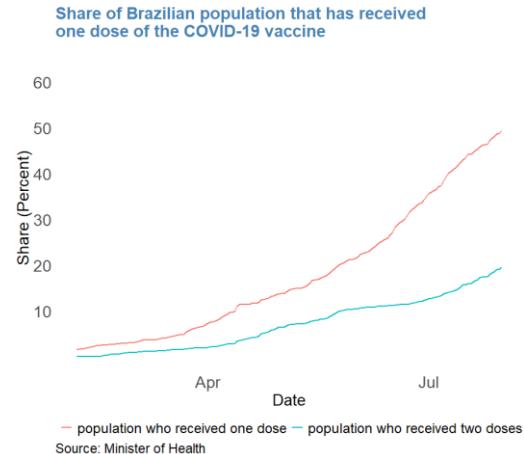
...and ranked second in terms of cumulative deaths.



The vaccination rollout is gaining momentum, ...



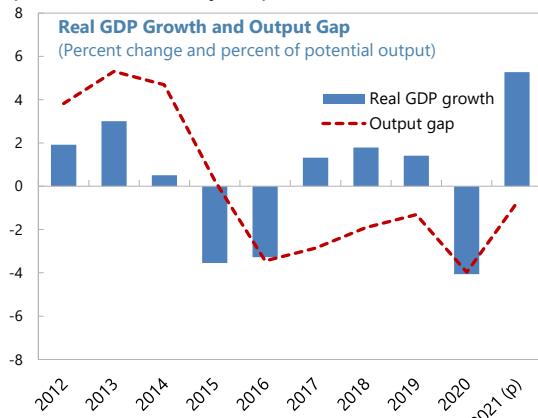
But the speed in getting a second dose has been more gradual.



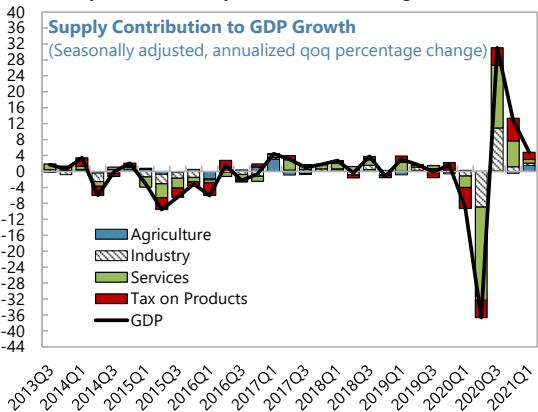
Sources: Johns Hopkins University, Ministry of Health, Google Mobility, and IMF staff calculations.

Figure 2. Brazil: Real Sector Developments

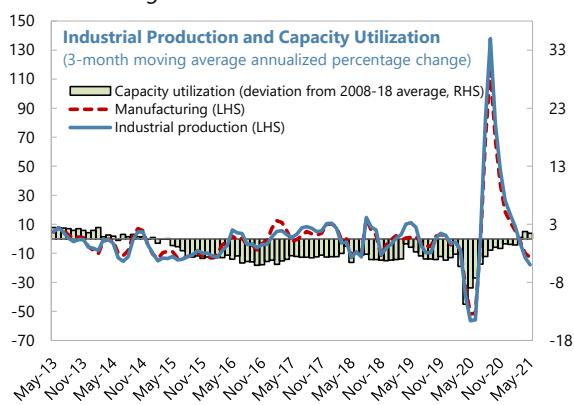
Real GDP contracted by 4.1 percent in 2020 and is expected to rebound by 5.3 percent in 2021.



The service sector was the most affected by the reduction in mobility and has not yet recovered lost ground.

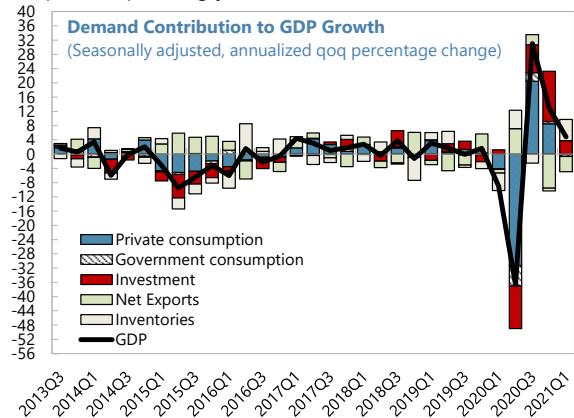


Industrial production and manufacturing led the recovery in 2020H2, as capacity utilization returned to the historical average.

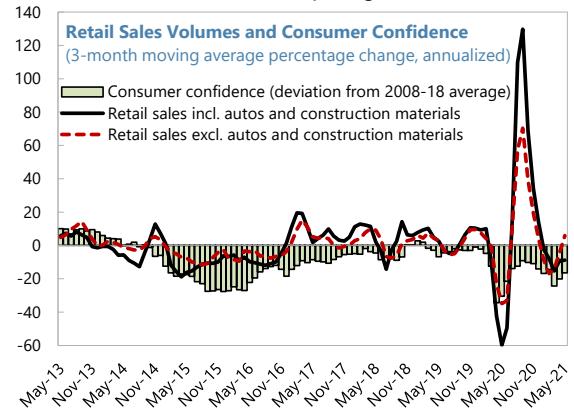


Sources: Haver analytics; IBGE; and IMF staff calculations.

Private consumption and investment fell sharply in 2020Q2 but picked up strongly in Q3 and Q4.



Retail sales grew strongly in 2020H2 despite weak consumer confidence, before tapering off in 2021Q1.



Investment grew strongly with the resumption of business confidence (and rising commodity prices)

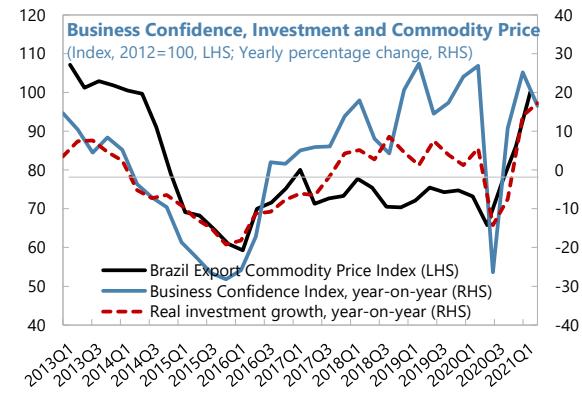
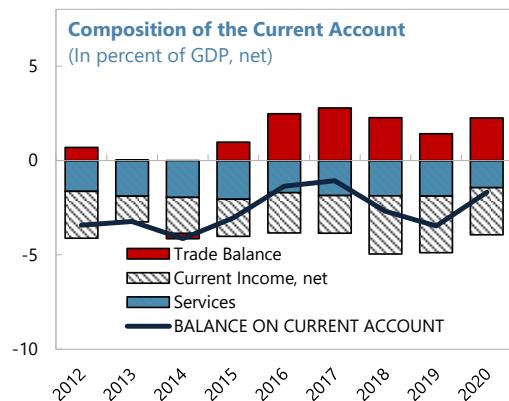
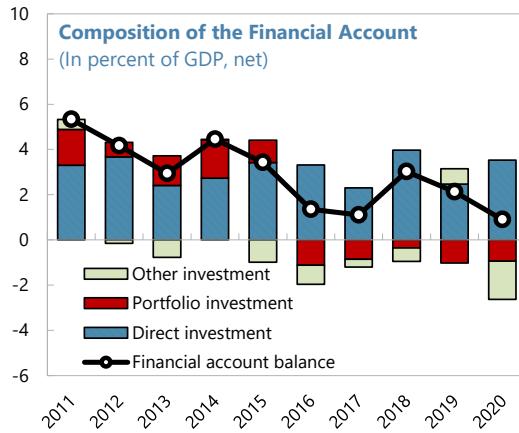


Figure 3. Brazil: External Sector Developments

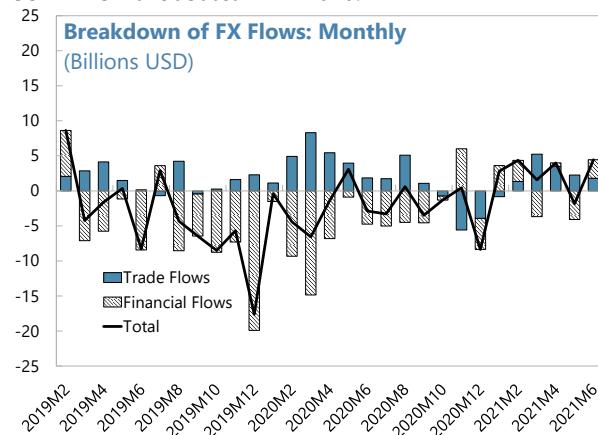
The current account improved in 2020 with lower services and net income abroad, and a strong trade balance...



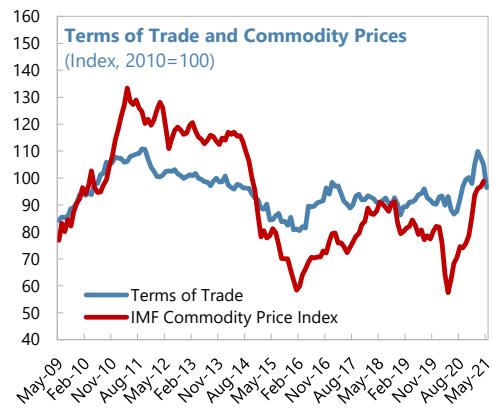
FDI and portfolio flows closed the year in line with the annual average of previous years...



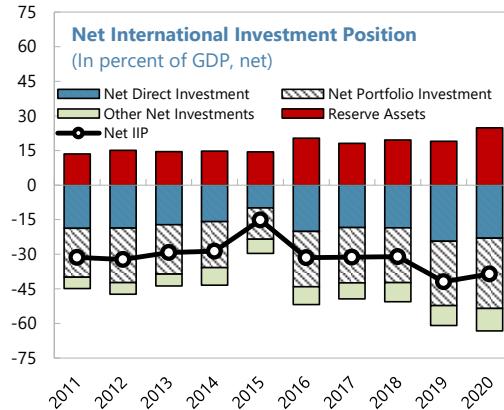
Large financial FX outflows during the peak of the first COVID-19 wave abated in H2 2020.



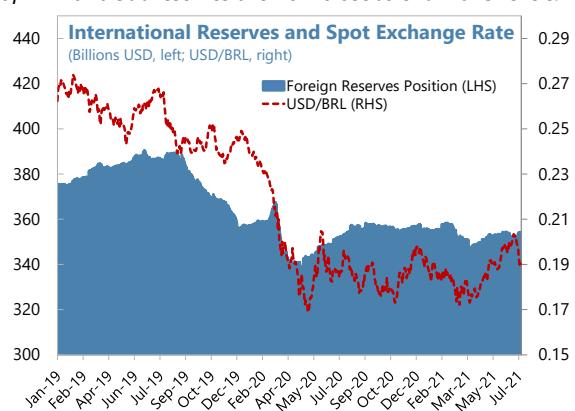
...as the terms of trade rose to the highest level since 2011 driven by the surge in commodity prices.



...leaving the net IIP broadly unchanged in 2020.



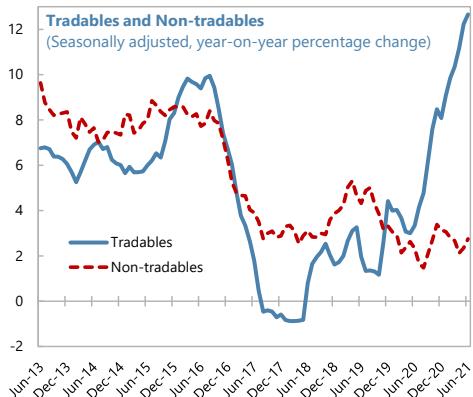
The exchange rate has not reversed the large depreciation of H1 2020 but reserves are now close to end-2019 levels.



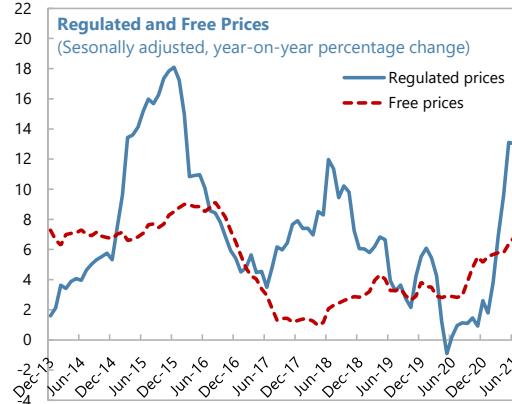
Sources: Central Bank of Brazil; Haver Analytics; and Fund staff calculations.

Figure 4. Brazil: Monetary Sector Developments

Tradable inflation has increased steadily since mid-2020, driven by commodity prices and the BRL depreciation....



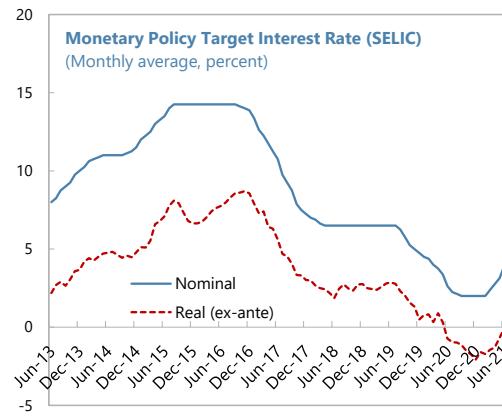
...resulting in higher regulated and free prices, and lifted headline inflation above target since November 2020.



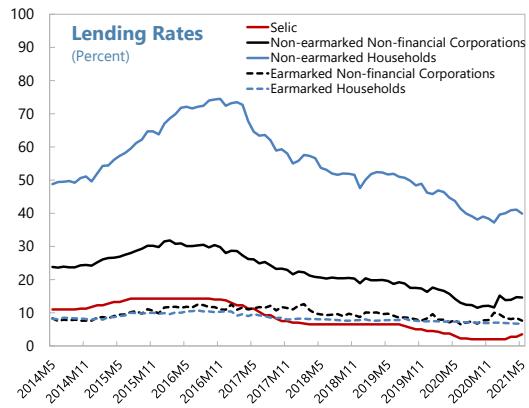
Real average earnings and the real minimum wage fell accordingly.



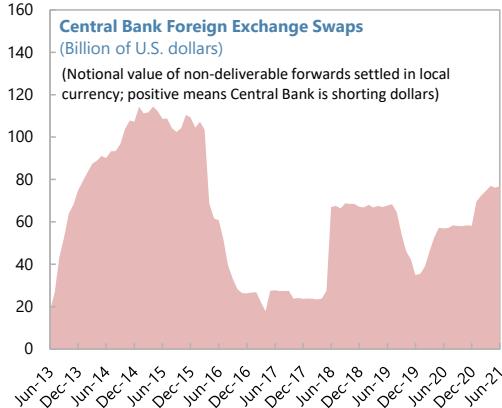
The BCB has raised the policy rate by 325 basis points but the real rate remains negative.



Lending rates have been decreasing since mid-2017 but ticked up in January.



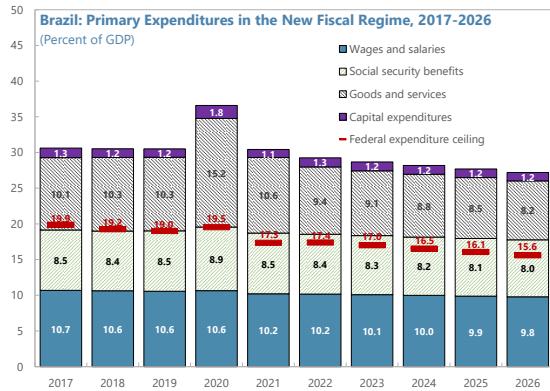
To contain BRL volatility, the BCB has intervened in the FX market, increasing the stock of outstanding swaps.



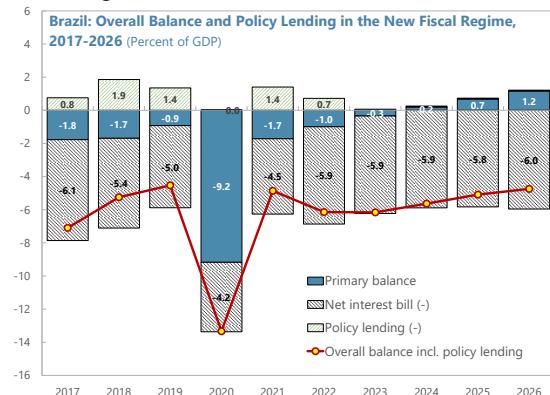
Sources: Haver Analytics, IBGE, BCB, and Fund Staff calculations.

Figure 5. Brazil: Fiscal Sector Developments

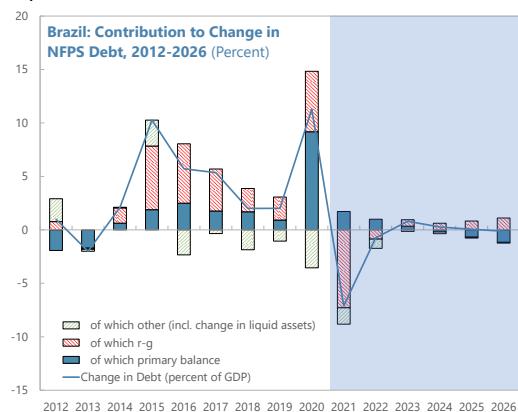
The expenditure ceiling will compress primary expenditures by 3.2 percent of GDP over the next 5 years (a total reduction of 3.7 percent of GDP over 2017-26).



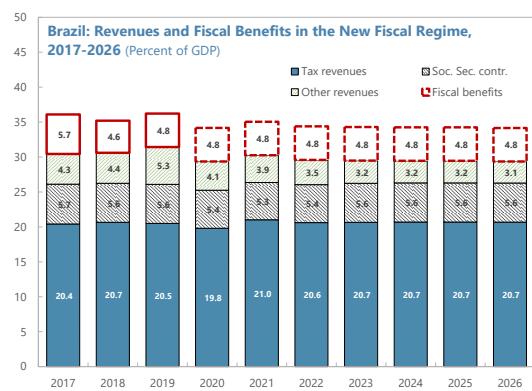
Over the MT, new primary savings will be partially offset by rising interest expenses, and the overall deficit will remain high.



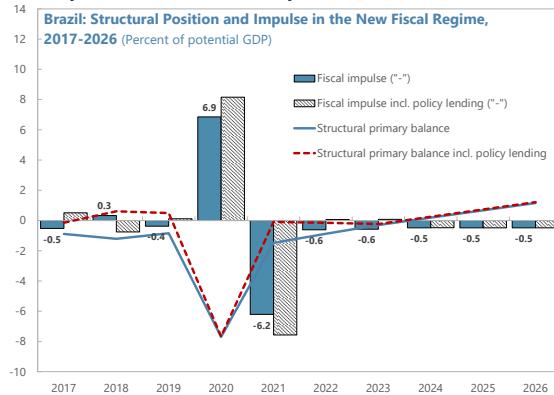
Growth-interest rate differential and use of assets are expected to reduce debt in 2021 and 2022.



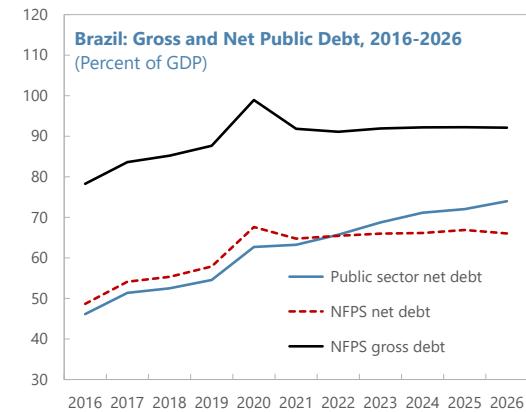
Foregone revenues from tax expenditures (4.2 percent of GDP) and non-tax subsidies (0.6 percent of GDP) offer a potential source of consolidation.



The fiscal stance will remain contractionary into the medium-term with the positive 2020 impulse almost entirely offset in 2021 already.



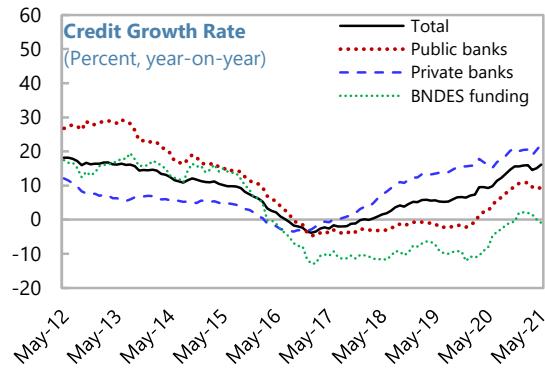
...but gross debt is set to remain around 92 percent of GDP in the medium-term.



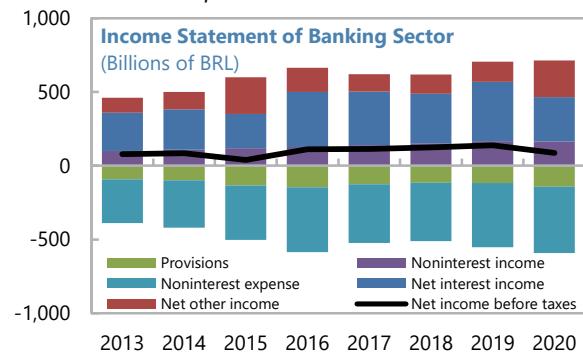
Source: Ministry of Economy and IMF staff calculations.

Figure 6. Brazil: Financial Sector Developments

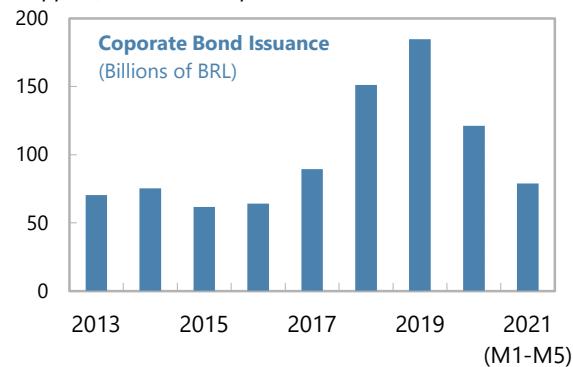
Credit growth increased during the pandemic, largely driven by government credit incentive programs....



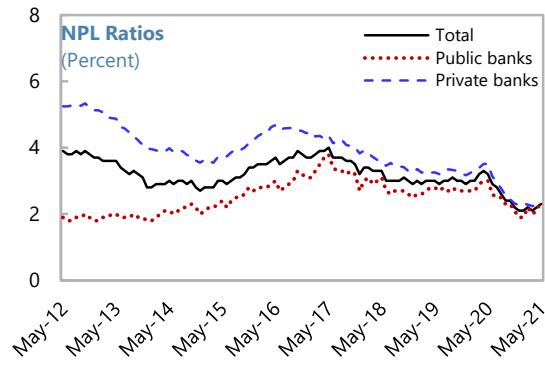
Bank profitability declined somewhat as increased competition reduced margins on lending and provisions were increased as a precaution....



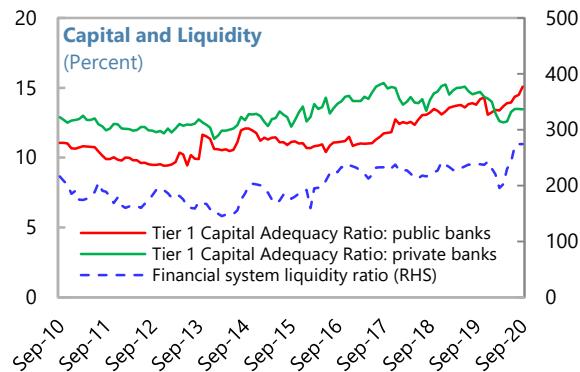
With bank loans accelerating in 2020, corporate issuances dropped from the 2019 peak.



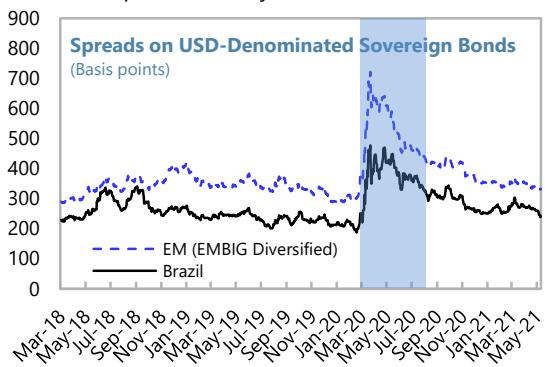
NPLs have fallen due to the restructuring of loans and debt moratoria....



Capital and liquidity buffers have remained well above regulatory minima....



Unlike the exchange rate, spreads on USD bonds reverted most of the spike from early 2020, in line with other EMs.



Sources: BCB, Capital IQ, CEIC, Bloomberg and IMF staff calculations.

Table 1. Brazil: Selected Economic Indicators

I. Social and Demographic Indicators									
Area (thousands of sq. km)	8,510	Health							
Agricultural land (percent of land area)	30.2	Physician per 1000 people (2018)							2.2
Population		Hospital beds per 1000 people (2018)							2.2
Total (million) (est., 2019)	210.1	Access to safe water (2018)							83.6
Annual rate of growth (percent, 2018)	0.8	Education							
Density (per sq. km.) (2019)	25.3	Adult illiteracy rate (2019)							6.6
Unemployment rate (2019)	11.9	Net enrollment rates, percent in:							
Population characteristics (2018)		Primary education (2019)							98
Life expectancy at birth (years)	76	Secondary education (2019)							85
Infant mortality (per thousand live births)	12	Poverty rate (in percent, 2018) 1/							25.3
Income distribution (2017)		GDP, local currency (2020)							R\$7,448 billion
Ratio between average income of top 10 percent of earners over bottom 40 percent	12.4	GDP, dollars (2020)							US\$1,445 billion
Gini coefficient (2018)	53.9	GDP per capita (2020)							US\$6,875
Main export products: airplanes, metallurgical products, soybeans, automobiles, electronic products, iron ore, coffee, and oil.									
II. ECONOMIC INDICATORS									
	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Proj.								
	(Percentage change)								
National accounts and prices									
GDP at current prices	5.0	6.4	5.8	0.6	15.0	7.8	6.1	6.4	6.2
GDP at constant prices	1.3	1.8	1.4	-4.1	5.3	1.9	2.0	2.1	2.1
Consumption	1.4	2.0	1.6	-5.3	3.5	1.6	1.5	1.5	1.5
Investment (GFCF)	-2.6	5.2	3.4	-0.8	11.8	4.1	5.0	5.2	4.0
Consumer prices (IPCA, end of period)	2.9	3.7	4.3	4.5	5.8	3.7	3.3	3.0	3.0
(Percent of GDP)									
Gross domestic investment									
Private sector	12.3	13.0	13.3	12.7	14.5	14.6	15.1	15.8	16.2
Public sector	2.3	2.1	2.1	2.7	2.0	2.3	2.3	2.2	2.2
Gross national savings									
Private sector	20.1	18.6	17.2	26.6	22.1	21.5	20.6	20.1	19.7
Public sector	-6.5	-5.9	-4.7	-11.6	-5.2	-5.6	-5.0	-4.5	-4.0
Public sector finances									
Central government primary balance 2/	-1.9	-1.8	-1.3	-10.0	-1.9	-0.8	-0.3	0.2	0.7
NFPS primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7
NFPS cyclically adjusted primary balance (in percent of potential GDP)	-0.9	-1.1	-0.5	-7.7	-1.5	-0.9	-0.3	0.2	0.7
NFPS overall balance	-7.9	-7.1	-5.9	-13.4	-6.3	-6.9	-6.2	-5.7	-5.2
Net public sector debt	51.4	52.8	54.6	62.7	63.9	66.4	69.4	71.8	72.6
General Government gross debt, Authorities' definition	73.7	75.3	74.3	88.8	82.6	81.8	83.2	84.0	83.6
NFPS gross debt	83.6	85.6	87.7	98.9	91.6	90.9	91.7	92.0	92.1
Of which: Foreign currency linked	3.6	4.1	4.2	5.8	5.2	5.0	4.9	4.9	4.7
Money and credit									
(Annual percentage change)									
Base money 3/	9.6	1.6	3.3	8.0	15.0	7.8	6.1	6.4	6.2
Broad money 4/	4.6	8.1	8.6	18.6	13.9	10.1	8.1	7.9	8.0
Bank loans to the private sector	0.0	7.7	5.9	16.4	10.0	9.0	9.0	8.0	8.0
Balance of payments									
(Billions of U.S. dollars, unless otherwise specified)									
Trade balance	57.3	43.4	26.5	32.4	76.1	63.4	55.9	49.7	50.0
Exports	218.0	239.5	225.8	210.7	281.2	280.4	279.9	283.6	294.0
Imports	160.7	196.1	199.3	178.3	205.2	217.0	224.1	234.0	244.0
Current account	-22.0	-51.5	-65.0	-25.9	7.1	-19.1	-38.3	-54.1	-64.5
Capital account and financial account	17.5	52.8	64.7	22.8	-7.1	19.1	38.3	54.1	64.5
Foreign direct investment (net inflows)	47.5	76.1	46.4	48.1	57.9	64.8	69.5	72.8	75.9
Terms of trade (percentage change)	15.6	-2.2	0.6	-7.0	15.1	-3.9	-1.6	-1.3	-1.1
Merchandise exports (in US\$, annual percentage change)	18.3	9.9	-5.7	-6.7	33.5	-0.3	-0.2	1.3	3.6
Merchandise imports (in US\$, annual percentage change)	15.0	22.1	1.6	-10.5	15.0	5.8	3.2	4.4	4.3
Total external debt (in percent of GDP)	32.3	34.7	36.0	44.3	37.7	31.8	29.3	27.5	26.3
Memorandum items:									
Output Gap	-2.9	-1.9	-1.3	-4.0	-0.7	-0.4	-0.2	0.0	0.0
Current account (in percent of GDP)	-1.1	-2.7	-3.5	-1.8	0.4	-1.0	-1.8	-2.3	-2.6
Unemployment rate	12.7	12.3	11.9	13.5	13.7	12.9	11.7	10.9	10.2
Gross official reserves	374	375	357	356	353	353	353	353	353
REER (annual average in percent; appreciation +)	8.5	-10.4	-1.8	-20.6

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

1/ Computed by IBGE using the World Bank threshold for upper-middle income countries of US\$5.5/day. This number is not comparable to the estimates provided by IPEA in previous years due to methodological differences.

2/ Includes the federal government, the central bank, and the social security system (INSS). Based on the 2017 draft budget, recent announcements by the authorities, and staff projections.

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

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

Table 2. Brazil: Balance of Payments
(in billions of U.S. dollars, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Proj.
Current Account	-22.0	-51.5	-65.0	-25.9	7.1	-19.1	-38.3	-54.1	-64.5	-74.2	
Trade balance	57.3	43.4	26.5	32.4	76.1	63.4	55.9	49.7	50.0	50.8	
Exports (fob)	218.0	239.5	225.8	210.7	281.2	280.4	279.9	283.6	294.0	304.4	
Imports (fob)	160.7	196.1	199.3	178.3	205.2	217.0	224.1	234.0	244.0	253.6	
Income, net	-41.0	-58.8	-56.1	-37.4	-48.6	-56.2	-62.6	-67.1	-73.1	-78.6	
Capital and Financial Account	17.5	52.8	64.7	22.8	-7.1	19.1	38.3	54.1	64.5	74.2	
Capital account	0.4	0.4	0.4	4.1	0.3	0.3	0.3	0.3	0.3	0.3	
Financial account 1/	17.1	52.3	64.4	18.6	-7.3	18.8	38.0	53.8	64.3	73.9	
Direct investment, net	47.5	76.1	46.4	48.1	57.9	64.8	69.5	72.8	75.9	74.3	
Assets	21.3	2.0	22.8	-3.5	-3.2	-3.1	-2.6	-1.9	-0.9	-0.4	
Liabilities	68.9	78.2	69.2	44.7	54.7	61.7	66.9	70.9	75.0	73.9	
Portfolio investment, net	-17.7	-6.9	-19.2	-13.6	-13.5	-14.3	-13.0	-11.5	-9.7	-7.8	
Financial Derivatives, net	-0.7	-2.8	-1.7	-5.4	-5.5	-5.8	-6.1	-6.4	-6.6	-7.3	
Other investment, net	-6.9	-11.3	12.8	-24.7	-27.3	-25.8	-12.4	-1.2	4.7	14.6	
Change in Reserve Assets, net	-5.1	-2.9	26.1	14.2	-19.0	0.0	0.0	0.0	0.0	0.0	
Errors and Omissions	4.6	-1.3	0.3	3.1	0.0	0.0	0.0	0.0	0.0	0.0	
Memorandum Items:											
Gross reserves (eop) 1/											
In billions of U.S. dollars	374.0	374.7	356.9	355.6	353.4	353.4	353.4	353.4	353.4	353.4	
Current account (in percent of GDP)	-1.1	-2.7	-3.5	-1.8	0.4	-1.0	-1.8	-2.3	-2.6	-2.8	
Trade balance (in percent of GDP)	2.8	2.3	1.4	2.2	4.6	3.3	2.6	2.2	2.0	1.9	
Merchandise exports (in percent of GDP)	10.6	12.5	12.0	14.6	16.9	14.4	13.2	12.3	11.8	11.5	
Merchandise imports (in percent of GDP)	7.8	10.2	10.6	12.3	12.3	11.2	10.6	10.1	9.8	9.6	
Export volume (yo change, in percent)	5.4	3.5	-1.6	-1.2	4.1	4.7	2.2	1.7	3.5	3.4	
Import volume (yo change, in percent)	10.2	6.6	5.3	-7.7	4.2	7.9	5.1	4.2	4.0	3.8	
Export price index (yo change, in percent)	10.1	5.2	-3.9	-6.8	28.8	-3.6	-1.6	-0.1	0.3	0.3	
Import pnce index (yo change, in percent)	4.0	/4	-4.5	-8.2	11.8	0.3	0.0	1.2	1.4	1.2	
Terms of trade (yo change, in percent)	15.6	-2.2	0.6	-7.0	15.1	-3.9	-1.6	-1.3	-1.1	-0.9	
Oil price (Brent blend; US\$ per barrel)	52.8	68.3	61.4	41.3	58.5	54.8	52.5	51.3	50.7	50.5	
Nominal exchange rate (R\$/US\$, annual average)	3.19	3.65	3.9	5.2	5.1	4.8	4.6	4.5	4.4	4.4	
REER (annual average in percent; appreciation +)	8.5	-10.4	-1.8	-20.6	
GDP in billions of U.S. dollars	2,064	1,917	1,878	1,445	1,666	1,943	2,116	2,309	2,488	2,649	

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

1/Historical numbers include valuation changes.

Table 3. Brazil: Main Fiscal Aggregates
 (in percent of GDP, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Proj.
FEDERAL GOVERNMENT 1/											
Net nonfinancial revenue	17.5	17.5	18.2	16.1	17.5	17.2	17.2	17.3	17.3	17.3	
Revenue administered by SRF	12.7	12.9	12.8	12.1	13.3	13.1	13.1	13.1	13.1	13.1	13.1
PIT	2.6	2.7	2.8	2.7	2.8	2.8	2.8	2.8	2.8	2.8	2.8
CIT	3.7	3.6	3.7	3.5	4.0	3.9	3.9	3.9	3.9	3.9	3.9
Indirect taxes	5.9	5.9	5.4	4.9	5.5	5.4	5.3	5.3	5.3	5.3	5.3
Trade taxes	0.5	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Other	0.0	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social security contributions	5.7	5.6	5.6	5.4	5.3	5.4	5.6	5.6	5.6	5.6	5.6
Other revenue	2.6	2.6	3.7	2.2	2.6	2.4	2.3	2.3	2.3	2.3	2.3
Transfers to subnational governments (-)	-3.5	-3.7	-3.9	-3.5	-3.8	-3.8	-3.8	-3.8	-3.8	-3.8	-3.8
Total primary expenditure 2/	19.4	19.3	19.5	26.1	19.4	18.0	17.5	17.1	16.6	16.1	
Current expenditures	18.7	18.5	18.7	24.7	18.7	17.1	16.7	16.4	16.1	15.7	
Personnel	4.3	4.3	4.2	4.3	3.9	3.8	3.8	3.7	3.5	3.4	
Pension benefits	8.5	8.4	8.5	8.9	8.5	8.4	8.3	8.2	8.1	8.0	
Other	6.0	5.9	6.0	11.5	6.3	4.9	4.7	4.6	4.4	4.3	
Capital expenditures	0.7	0.8	0.8	1.4	0.7	0.9	0.8	0.8	0.8	0.8	
Unallocated spending cuts	N.A.	N.A.	0.0	0.0	0.0	0.0	0.0	-0.1	-0.2	-0.4	
of which reform of urban civil pensions (RGPS)	N.A.	N.A.	N.A.	-0.5	-0.6	-0.7	-0.7	-0.7	-0.8	-0.9	
Fund surpluses and statistical discrepancy	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Primary balance	-1.9	-1.8	-1.3	-10.0	-1.9	-0.8	-0.3	0.2	0.7	1.2	
Borrowing requirement	7.1	6.2	5.5	13.6	5.9	5.9	5.4	4.9	4.3	4.0	
STATES AND MUNICIPALITIES											
States											
Nonfinancial revenue	11.3	11.3	11.3	11.9	11.4	11.2	11.2	11.3	11.2	11.2	
Own revenues	8.7	8.7	8.7	8.7	8.7	8.5	8.5	8.5	8.5	8.5	
Indirect taxes	5.7	5.7	5.7	5.7	5.6	5.5	5.5	5.5	5.5	5.5	
Other	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	
Transfers from the federal government	2.6	2.6	2.6	3.2	2.7	2.7	2.7	2.7	2.7	2.7	
Total primary expenditure	11.2	11.2	11.1	11.1	11.2	11.4	11.2	11.2	11.2	11.2	
Current expenditures	10.6	10.8	10.7	10.7	10.8	11.0	10.9	10.8	10.8	10.8	
Personnel	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	
Other	4.5	4.7	4.6	4.6	4.7	4.9	4.8	4.7	4.7	4.7	
Capital expenditures and other	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	
Primary balance of municipalities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Primary balance of states and municipalities	0.1	0.0	0.2	0.8	0.2	-0.2	0.0	0.1	0.1	0.0	
Borrowing requirement	0.7	0.8	0.5	0.0	0.3	0.9	0.7	0.7	0.7	0.7	
PUBLIC ENTERPRISES 3/											
Federal enterprises											
Nonfinancial revenue	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
Expenditures	0.6	0.6	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6	
Personnel	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
Other current expenditures	0.3	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	
Capital expenditures	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
State and municipal enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Primary balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Primary balance of state and municipal enterprises	0.0	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.1	0.0	
Borrowing requirement	0.1	0.0	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	
NON FINANCIAL PUBLIC SECTOR (NFPS)											
Primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2	
Primary balance (Authorities' target)	-2.6	-2.3	-2.2	-1.8	-1.4	-0.7	-0.3	0.0	0.0	0.0	
Overall balance	-7.9	-7.1	-5.9	-13.7	-6.3	-6.9	-6.2	-5.7	-5.2	-4.8	
Structural primary balance 4/	-0.9	-1.2	-0.9	-8.0	-1.5	-0.9	-0.3	0.2	0.7	1.2	
Structural primary balance including policy lending	-0.2	0.6	0.5	-8.0	-0.1	-0.2	-0.2	0.2	0.7	1.2	
Memorandum items											
Loans to public financial institutions 5/	-0.8	-1.9	-1.4	0.0	-1.4	-0.7	-0.1	-0.1	-0.1	-0.1	
NFPS net interest expenditure	6.1	5.4	5.0	4.5	4.6	5.9	5.9	5.9	5.8	6.0	
Net public sector debt 6/	51.4	52.8	54.6	62.7	63.9	66.4	69.4	71.8	72.6	74.6	
Gross NFPS debt	83.6	85.6	87.7	98.9	91.6	90.9	91.7	92.0	92.1	92.0	
General government debt, Authorities' definition	74.1	77.2	
Nominal GDP (billions of reais)	6,585	7,004	7,407	7,448	8,567	9,231	9,798	10,423	11,071	11,748	

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

1/ Comprises the central administration and the social security system.

2/ Total primary expenditure is the sum of current (on trend) plus capital (on trend) expenditures, minus unallocated cuts to meet the ceiling.

3/ Excluding Petrobras and Eletrobras.

4/ Structural primary balance adjusts for output gap and one-off measures.

5/ Policy lending to BNDES and others.

6/ Includes assets, which mainly comprise international reserves, financial assets of public enterprises, and assets of the federal labor fund (FAT).

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

	2016	2017	2018	2019	2020
I. Central Bank					
Net foreign assets	1,179.8	1,225.0	1,464.9	1,421.6	1,823.9
Net international reserves	1,179.0	1,213.5	1,433.1	1,408.0	1,790.2
Other foreign assets (net)	0.9	11.6	31.8	13.6	33.8
Net domestic assets	-537.3	-520.6	-749.0	-682.0	-1,025.0
Net claims on public sector	467.8	566.4	493.1	424.9	470.5
Net credit to other depository corporations	-1,003.5	-1,011.0	-1,080.2	-902.1	-1,127.5
Other items (net)	1.7	76.0	161.9	204.8	368.0
Base money	642.5	704.4	715.8	739.6	798.9
Currency issued	232.1	250.4	265.0	280.7	370.4
Liabilities to other depository corporations	409.2	453.7	444.1	449.5	418.4
Reserve deposits	38.1	46.4	37.1	35.9	61.1
Liabilities to other sectors	1.2	0.4	6.8	9.4	10.1
II. Depository Corporations 1/					
Net foreign assets	968.2	971.2	1,171.3	1,070.7	1,297.8
Net international reserves	1,179.0	1,213.5	1,433.1	1,408.0	1,790.2
Other foreign assets (net)	-210.8	-242.2	-261.8	-337.3	-492.3
Net domestic assets	4,452.5	4,701.0	4,959.3	5,584.2	6,598.1
Net claims on public sector	2,310.1	2,823.5	3,085.9	3,544.4	4,288.6
Credit to other financial corporations	526.7	336.8	244.4	294.2	377.8
Credit to private sector	3,897.6	3,917.3	4,217.8	4,639.7	5,227.5
Of which: loans to private sector	2,824.4	2,824.8	3,043.3	3,224.0	3,753.4
Other items (net)	2,515.7	2,597.6	2,804.3	3,086.6	3,515.1
Capital	761.9	888.3	1,048.3	1,209.5	1,492.0
Other liabilities excluded from broad money	1,753.8	1,709.3	1,756.0	1,877.1	2,023.1
Broad money (M2) 2/	5,420.6	5,672.3	6,130.6	6,654.9	7,895.9
Currency in circulation	192.0	203.9	218.2	228.3	308.9
Demand deposits	169.8	178.1	190.0	216.6	328.6
Quasi-money liabilities	5,058.9	5,290.2	5,722.5	6,209.9	7,258.4
(Percent of GDP)					
Base money	10.2	10.7	10.2	10.0	10.7
Broad money (M2)	86.5	86.1	87.5	89.8	106.0
Financial sector credit to the private sector	62.2	59.5	60.2	62.6	70.2
Of which: bank loans to private sector	45.1	42.9	43.5	43.5	50.4
Memorandum item:					
GDP (in billions of reais)	6,269	6,585	7,004	7,407	7,448

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

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

Table 5. Brazil: Medium-Term Macroeconomic Framework

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Proj.
MACROECONOMIC FRAMEWORK											
GDP growth at constant prices (percent)	1.3	1.8	1.4	-4.1	5.3	1.9	2.0	2.1	2.1	2.1	(Percent of GDP, unless otherwise specified)
Consumer prices (IPCA, end of period, percent)	2.9	3.7	4.3	4.5	5.8	3.7	3.3	3.0	3.0	3.0	
Gross domestic investment	14.6	15.1	15.4	15.4	16.5	16.9	17.4	18.0	18.4	18.8	
Private sector	12.3	13.0	13.3	12.7	14.5	14.6	15.1	15.8	16.2	16.6	
Public sector	2.3	2.1	2.1	2.7	2.0	2.3	2.3	2.2	2.2	2.2	
Gross domestic savings	13.6	12.7	12.5	15.0	16.9	15.9	15.6	15.7	15.8	16.0	
Private sector	20.1	18.6	17.2	26.6	22.1	21.5	20.6	20.1	19.7	19.6	
Public sector	-6.5	-5.9	-4.7	-11.6	-5.2	-5.6	-5.0	-4.5	-4.0	-3.6	
External current account balance	-1.1	-2.7	-3.5	-1.8	0.4	-1.0	-1.8	-2.3	-2.6	-2.8	
Central government primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2	
Consolidated non-financial public sector											
Primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2	
Overall balance	-7.9	-7.1	-5.9	-13.4	-6.3	-6.9	-6.2	-5.7	-5.2	-4.8	
Public sector net debt 1/	51.4	52.8	54.6	62.7	63.9	66.4	69.4	71.8	72.6	74.6	
General government gross debt, Authorities' definition	73.7	75.3	74.3	88.8	82.6	81.8	83.2	84.0	83.6	84.5	
NFPS gross debt 2/	83.6	85.6	87.7	98.9	91.6	90.9	91.7	92.0	92.1	92.0	
EXTERNAL DEBT 3/ 4/											
(Billions of U.S. dollars)											
Total external debt	667.1	665.8	675.8	639.3	627.5	617.9	621.0	634.8	654.4	683.6	
Medium- and long-term	615.8	598.9	596.6	570.3	559.7	551.2	554.0	566.3	583.8	609.9	
Nonfinancial public sector	197.7	181.7	184.5	173.4	170.2	167.6	168.4	172.1	177.5	185.4	
Public sector banks	60.0	38.1	43.8	41.4	40.6	40.0	40.2	41.1	42.3	44.2	
Private sector	409.4	446.0	447.5	424.6	438.1	456.6	482.1	512.9	547.7	587.8	
Short-term	51.3	66.8	79.2	69.0	67.7	66.7	67.0	68.5	70.6	73.8	
Medium- and long-term external debt service	113.6	116.4	109.0	119.0	104.4	96.3	94.3	91.5	90.9	92.3	
Amortization	93.1	93.8	86.3	98.4	85.7	78.7	77.0	74.5	73.7	74.7	
Interest	20.5	22.6	22.7	20.6	18.7	17.7	17.3	17.1	17.2	17.5	
(Percent of GDP)											
Total external debt	32.3	34.7	36.0	44.3	37.7	31.8	29.3	27.5	26.3	25.8	
Medium- and long-term	29.8	31.2	31.8	39.5	33.6	28.4	26.2	24.5	23.5	23.0	
Nonfinancial public sector	9.6	9.5	9.8	12.0	10.2	8.6	8.0	7.5	7.1	7.0	
Public sector banks	2.9	2.0	2.3	2.9	2.4	2.1	1.9	1.8	1.7	1.7	
Private sector	19.8	23.3	23.8	29.4	26.3	23.5	22.8	22.2	22.0	22.2	
Short-term	2.5	3.5	4.2	4.8	4.1	3.4	3.2	3.0	2.8	2.8	
(Percent of gross international reserves)											
Medium- and long-term external debt service	30.4	31.1	30.5	33.5	29.5	27.3	26.7	25.9	25.7	26.1	
Amortization	24.9	25.0	24.2	27.7	24.3	22.3	21.8	21.1	20.8	21.1	
Interest	5.5	6.0	6.4	5.8	5.3	5.0	4.9	4.8	4.9	5.0	
Short-term debt	13.7	17.8	22.2	19.4	19.2	18.9	19.0	19.4	20.0	20.9	
MEMORANDUM ITEMS:											
Gross reserves (eop) 4/											
In billions of U.S. dollars	374.0	374.7	356.9	355.6	353.4	353.4	353.4	353.4	353.4	353.4	
In percent of external short-term debt (maturity basis)	729.2	560.6	450.7	515.5	522.0	530.1	527.4	516.0	500.5	479.1	
In months of prospective GNFS imports	16.8	16.7	18.4	14.9	14.8	14.1	13.4	12.7	12.7	12.1	
In percent of external short-term debt (residual maturity)	257.7	244.7	200.9	229.8	241.5	246.0	249.8	248.6	243.2	235.9	
Short-term debt in percent of total external debt	7.7	10.0	11.7	10.8	10.8	10.8	10.8	10.8	10.8	10.8	
Intercompany debt (in billions of U.S. dollars)	227.8	238.6	250.7	244.1	260.9	282.2	306.8	333.7	363.0	394.8	
In percent of GDP	11.0	12.4	13.3	16.9	15.7	14.5	14.5	14.4	14.6	14.9	
GDP (billion US\$)	2,064	1,917	1,878	1,445	1,666	1,943	2,116	2,309	2,488	2,649	

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/ Gross non financial public sector debt consolidates debt of public enterprises with that of general government.

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
(in billions of U.S. dollars, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	Proj. 2021
Trade							
Exports of GNFS (12-month percent change, US\$)	-15.2	-2.8	16.1	8.9	-5.4	-8.0	34.1
Imports of GNFS (12-month percent change, US\$)	-23.7	-16.3	14.7	14.6	0.6	-15.3	16.5
Terms of trade (12-month percent change)	-11.0	3.0	15.6	-2.2	0.6	-7.0	15.1
Current account							
Current account	-54.8	-24.5	-22.0	-51.5	-65.0	-25.9	7.1
In percent of GDP	-3.0	-1.4	-1.1	-2.7	-3.5	-1.8	0.4
Capital and financial account							
Capital Account	57.1	16.4	17.5	52.8	64.7	22.8	-7.1
Financial Account	0.5	0.3	0.4	0.4	0.4	4.1	0.3
Portfolio investment (net)	56.6	16.1	17.1	52.3	64.4	18.6	-7.3
Foreign direct investment (net)	17.8	-20.0	-17.7	-6.9	-19.2	-13.6	-13.5
Of which: intercompany loans (net)	61.6	59.6	47.5	76.1	46.4	48.1	57.9
Short-term external liabilities of commercial banks	23.7	25.7	4.8	16.5	3.5	2.8	15.4
Total external debt 1/	42.7	46.8	42.1	45.6	60.0	51.5	50.5
External debt							
In percent of gross reserves	664.4	675.8	667.1	665.8	675.8	639.3	627.5
Amortization of external MLT debt (in percent of GNFS exports)	186.4	185.2	178.4	177.7	189.4	179.8	177.5
External interest payments (in percent of GNFS exports)	51.2	52.2	42.7	39.2	38.2	46.7	30.5
Gross reserves	9.8	10.3	9.4	9.4	10.1	9.8	6.6
Reserves							
In months of prospective GNFS imports	356.5	365.0	374.0	374.7	356.9	355.6	353.4
In percent of broad money (M2)	21.0	18.8	16.8	16.7	18.4	14.9	14.8
In percent of short-term external debt (maturity basis)	28.9	21.9	21.8	23.7	21.6	23.4	19.1
In percent of IMF metric	241.8	244.2	257.7	244.7	200.9	229.8	...
Exchange rate	192.2	167.0	160.8	167.8	157.7
Exchange rate (R\$/US\$, period average)	3.33	3.49	3.19	3.65	3.94	5.16	5.14
REER (annual average in percent; appreciation +)	-17.7	4.9	8.5	-10.4	-1.8	-20.6	...

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

1/ Includes intercompany loans.

Table 7. Brazil: Financial Soundness Indicators
(in percent)

	2015	2016	2017	2018	2019	2020M9
Total banking system						
Capital Adequacy						
Regulatory capital to risk-weighted assets	16.4	17.1	18.2	18.0	17.1	16.7
Regulatory Tier 1 capital to risk-weighted assets	12.7	13.7	14.5	14.6	14.3	14.3
Capital to assets	8.4	9.3	10.0	10.1	10.2	9.4
Gross asset position in financial derivatives to capital	29.6	22.8	19.5	18.4	19.0	39.0
Gross liability position in financial derivatives to capital	35.6	21.8	19.1	19.8	21.6	41.5
Asset Quality						
Nonperforming loans to total gross loans	3.3	3.9	3.6	3.1	3.1	2.4
Provisions to Nonperforming loans	154.4	152.2	163.1	180.3	178.9	231.9
Earnings and Profitability						
Return on assets	1.5	1.1	1.5	1.6	2.0	1.3
Return on equity	15.5	11.3	13.9	14.6	18.0	13.0
Liquidity						
Liquidity assets to short-term liabilities	190.0	236.3	237.5	241.9	242.7	274.5
Liquidity assets to total assets	11.6	14.1	14.6	14.7	14.2	17.5
Net open position in foreign exchange to capital	0.5	0.9	0.7	0.7	0.4	0.5
External funding to total funding	19.5	15.3	14.8	16.9	17.6	20.4
Liquidity Coverage Ratio	190	240	290	240	270	310
Net Stable Funding Ratio	106	107	112	115	113	118
Public banks						
Capital Adequacy						
Regulatory capital to risk-weighted assets	15.5	16.3	18.5	18.8	18.3	19.2
Regulatory Tier 1 capital to risk-weighted assets	11.0	11.5	12.7	13.1	13.1	15.1
Capital to assets	4.7	4.9	5.7	6.1	6.7	6.9
Gross asset position in financial derivatives to capital	8.2	2.6	1.6	1.7	1.1	3.9
Gross liability position in financial derivatives to capital	3.2	3.0	1.3	1.3	1.2	3.1
Asset Quality						
Nonperforming loans to total gross loans	2.5	3.3	3.1	2.6	2.7	1.9
Provisions to Nonperforming loans	157.8	146.6	158.6	190.9	185.0	232.8
Earnings and Profitability						
Return on assets	1.0	0.6	1.2	1.0	1.7	1.2
Return on equity	14.5	9.0	16.4	12.9	20.6	14.4
Liquidity						
Liquidity assets to short-term liabilities	196.0	282.0	308.7	345.2	438.4	414.4
Liquidity assets to total assets	9.7	13.2	14.8	16.3	19.0	20.0
Net open position in foreign exchange to capital	-1.2	4.4	2.2	4.0	2.1	0.7
External funding to total funding	9.1	6.5	5.7	6.1	5.8	7.0
Private banks (domestic and foreign)						
Capital Adequacy						
Regulatory capital to risk-weighted assets	17.3	17.6	18.0	17.8	16.3	15.2
Regulatory Tier 1 capital to risk-weighted assets	13.7	14.4	15.0	15.1	14.2	13.5
Capital to assets	11.0	12.3	13.3	12.7	12.2	10.7
Gross asset position in financial derivatives to capital	28.2	28.0	28.2	24.7	26.7	49.9
Gross liability position in financial derivatives to capital	35.3	27.9	27.3	24.5	27.4	47.6
Asset Quality						
Nonperforming loans to total gross loans	4.2	4.9	4.3	3.7	3.6	2.8
Provisions to Nonperforming loans	160.4	153.4	167.3	174.1	177.3	237.8
Earnings and Profitability						
Return on assets	2.2	1.7	1.9	2.0	2.2	1.4
Return on equity	19.0	14.2	14.2	15.7	17.2	12.0
Liquidity						
Liquidity assets to short-term liabilities	212.4	230.4	217.3	212.1	166.4	235.4
Liquidity assets to total assets	11.8	13.7	12.9	12.2	9.3	14.2
Net open position in foreign exchange to capital	0.8	-0.1	0.2	-0.2	-0.2	0.4
External funding to total funding	24.9	20.5	20.6	21.5	21.9	22.3

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

Annex I. External Sector Assessment

<p>Overall Assessment: The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies. In the wake of the COVID-19 shock, the current account deficit contracted due to the large currency depreciation and improvements in the service and income balances. The trend is expected to persist in 2021.</p> <p>Potential Policy Responses: Policies that would help keep the current account in line with its norm include desirable fiscal consolidation, accompanied by measures to support public and private investment, including supply side reforms to support a more competitive economy</p>						
<p>Foreign Asset and Liability Position and Trajectory</p> <p>Background. Brazil's NIIP was -38.3 percent of GDP at end-2020, moderately stronger than at end-2019 (-42 percent of GDP) mainly due to valuation effects associated with the currency depreciation (assets are predominantly denominated in FX while liabilities are more concentrated in local currency). At end-2020, external debt declined by about 5 percent in nominal terms compared to 2019, accounting for about 44.3 percent of GDP and 303 percent of exports, against a value of 36 percent of GDP and 299 percent of exports in 2019, with the large increase in the external debt to GDP ratio in 2020 driven by the significant output contraction when measured in USD.</p> <p>Assessment. Brazil's NIIP has been negative since 2001. Short-term gross external financing needs are significant, at around 11 percent of projected 2021 GDP, with capital flows and the exchange rate particularly sensitive to global financing conditions.</p>						
2020 (% GDP)	NIIP: -38.5	Gross Assets: 63.5	Res. Assets: 25.0	Gross Liab.: 102.0	Debt Liab.: 44.6	
<p>Current Account</p> <p>Background. The CA deficit contracted from -3.5 percent of GDP in 2019 to -1.7 in 2020 due to improvements in the trade, service, and income balances, supported, respectively, by the currency depreciation, the contraction in tourism and transport service imports and lower distribution of profits and dividends. In 2021, the trade balance is expected to continue improving on the back of a recovery in economic activity in trading partners that would boost exports, more than offsetting the rebound in imports. Overall, staff projects a CA balance of about 0.4 percent of GDP for 2021.</p> <p>Assessment. In 2020, the cyclically adjusted CA deficit was -1.8 percent of GDP. EBA estimates suggest a CA norm in 2020 of -2.4 percent of GDP. Staff assesses a CA norm between -1.9 and -2.9 percent of GDP. Thus, after adjusting for the transitory impacts of the COVID-19 crisis on the oil, travel services, including tourism, and medical goods sectors (resulting in an impact on the CA balance of 0.3 percent, -0.3 percent and 0.1 percent of GDP, respectively), the staff CA gap is assessed at 0.7 percent of GDP. The medium-term outlook for the CA is still difficult to assess given the unfolding COVID-19 crisis and related policy response.</p>						
2020 (% GDP)	CA: -1.7	Cycl. Adj. CA: -1.8	EBA Norm: -2.4	EBA Gap: 0.6	COVID-19 Adj.: 0.1	Other Adj.: 0
<p>Real Exchange Rate</p> <p>Background. After remaining broadly stable in 2019 (-1.9 percent), the REER depreciated sharply in 2020 (-20.6 percent), driven by large capital outflows in the first half of the year. Depreciation pressures have subsided since mid-May 2020.</p> <p>Assessment. The staff CA gap implies a REER gap of -5.4 percent in 2020 (applying an estimated elasticity of 0.13). The REER index (-36.5 percent) and level (-21.2 percent) methodologies point to some possible overshooting of the nominal exchange rate. Overall, staff assesses the REER gap at end-2020 to be closer to the REER gap implied by the staff CA gap. Therefore, considering the CA norm standard deviation of 0.8 percent, staff assesses the REER gap to be in the range of -11.4 to 0.6 percent, with a mid-point of -5.4 percent (undervaluation).</p>						
<p>Capital and Financial Accounts: Flows</p> <p>Background. Net FDI has fully financed CA deficits since 2015 (averaging 3.2 percent of GDP during 2015-20, while CA deficits averaged -2.2 percent), despite net portfolio outflows (0.6 percent of GDP on average during 2015-20). In 2020, net FDI stood at 3.5 percent of GDP, against a CA deficit of 1.7 percent. Net portfolio outflows accelerated sharply in the first half of the year before easing in the third quarter and then partly recovering in the fourth quarter, recording a balance of -0.9 percent of GDP over the year (-1 percent of GDP in 2019). Net FDI was stronger than in 2019, due to divestment abroad that more than compensated lower FDI inflows.</p> <p>Assessment. The composition of capital flows is expected to remain favorable over the medium-term with positive net FDI inflows outweighing negative portfolio outflows which started in 2016 following the sovereign's downgrade below investment grade. Nevertheless, the high degree of uncertainty about the scarring effects of COVID-19 on the global economy make it challenging to assess the medium-term prospects for capital flows. A renewed spike in international risk aversion, potentially linked to a second wave of COVID-19, or a sudden tightening of global financing conditions could trigger a new bout of capital market volatility.</p>						
<p>FX Intervention and Reserves Level</p> <p>Background. Brazil has a floating exchange rate. To dampen exchange rate volatility associated with the COVID-19 shock, in 2020 the Central Bank sold USD 21.2bn in the spot and repo markets and increased the stock of outstanding FX swaps by USD 23.3bn (the latter does not directly affect the level of reserves given they are settled in local currency). Nevertheless, reserves remain high at US\$334 billion at end-2020.</p> <p>Assessment. The flexible exchange rate has been an important shock absorber. Reserves are adequate relative to various criteria including the IMF's reserve adequacy metric (161 percent as of end-2020) and serve as insurance against external shocks. The authorities should retain strong external buffers, with intervention limited to addressing dysfunctional conditions in FX markets.</p>						

Annex II. External Sector Debt Sustainability Analysis

External debt is assessed to be sustainable over the medium term, but subject to risks. After a significant increase in 2020, mainly driven by the GDP contraction and exchange rate depreciation, external debt is expected to decline gradually. The debt path remains sensitive to real exchange rate shocks.

- 1. Total external debt increased from 36 to 44 percent of GDP in 2020.** The increase was predominantly driven by the substantial depreciation of the Brazilian *Real* following the COVID-19 shock as well as negative GDP growth, while the CA deficit contracted. 89 percent of debt is long-term, with inter-company loans accounting for 38 percent of total external debt. Around a quarter of total external debt is from the public sector, 60 percent of which is FX denominated. External financing needs increased from 11.6 to 14 percent of GDP, also on account of the depreciation.
- 2. The increase in external debt and financing needs is projected to be temporary.** Debt and gross financing needs are expected to fall to 37.6 and 8.9 percent of GDP, respectively, in 2021. This is driven by a current account surplus (supported by booming commodity prices), resuming GDP growth, a stabilizing exchange rate, and non-debt creating inflows on par with the average for previous years. Over the medium term, the CA is projected to return to trend, while economic growth is expected to fall toward potential. As shown in historical scenarios, if the current account, growth, interest rates, and real exchange rate remain at historical levels over the projection period, the external debt would increase to close to 60 percent of GDP by 2026.
- 3. The external debt path is particularly sensitive to real exchange rate depreciation shocks.** As shown in the shock scenarios, a 30 percent real depreciation would cause external debt to reach 53 percent of GDP during the first year and stabilize at 43 percent of GDP by 2026.
- 4. A significant deterioration of the fiscal position could also have an impact on external debt dynamics.** This could lead to higher current account deficits, higher interest rates and a slowdown in economic activity.

Table 1. Brazil: External Debt Sustainability Framework, 2016-2026

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	
Baseline: External debt	37.6	323	34.7	360	443	37.6	31.8	29.3	27.5	26.3	25.8	-4.2
Change in external debt	0.7	-53	2.4	1.3	83	-6.6	-5.9	-24	-19	-12	-5	0.0
Identified external debt-creating flows (4+8+9)	-2.6	-62	1.1	17	89	-6.0	-3.1	-23	-17	-13	-10	0.0
Current account deficit, excluding interest payments	0.3	0.1	1.5	23	02	-15	0.1	1.0	1.6	1.9	2.1	4.2
Deficit in balance of goods and services	-0.8	-0.9	-0.4	0.5	-0.8	-33	-1.9	-12	-0.6	-0.3	-0.2	
Exports	12.1	122	14.3	13.8	16.6	192	16.7	15.4	14.3	13.8	13.4	
Imports	11.3	113	14.0	143	157	159	14.7	14.2	13.7	13.4	13.3	
Net non-debt creating capital inflows (negative)	-3.9	-2.6	-3.8	-24	-3.1	-36	-3.4	-3.5	-3.4	-3.4	-3.2	-3.2
Automatic debt dynamics 1/	1.0	-37	3.4	1.8	11.8	-0.9	0.3	0.2	0.2	0.2	0.1	-0.9
Contribution from nominal interest rate	1.1	1.0	1.2	1.2	14	1.1	0.9	0.8	0.7	0.7	0.6	
Contribution from real GDP growth	1.2	-0.4	-0.6	-0.5	19	-20	-0.6	-0.6	-0.6	-0.5	-0.5	-0.5
Contribution from price and exchange rate changes 2/	-1.2	-43	2.8	1.1	85	-	-	-	-	-	-	-1.1
Residual, incl. change in gross foreign assets (2-3) 3/	3.3	0.9	1.3	-0.4	-0.7	-0.6	-2.8	-0.2	-0.2	0.2	0.5	0.0
External debt-to-exports ratio (in percent)	310.7	2642	242.2	259.8	267.3	195.6	190.9	190.9	192.0	190.7	192.0	
Gross external financing need (in billions of US dollars) 4/	171.9	1715	196.6	218.2	201.7	147.7	165.5	181.9	195.5	206.7	219.5	
in percent of GDP	9.6	83	10.3	11.6	14.0	10-Year	10-Year	8.9	8.5	8.6	8.5	8.3
Scenario with key variables at their historical averages 5/						37.6	41.0	44.6	48.6	53.0	57.9	0.6
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation					For debt stabilization
Real GDP growth (in percent)	-3.3	13	1.8	1.4	-4.1	0.3	2.9	53	1.9	2.0	2.1	2.1
GDP deflator in US dollars (change in percent)	3.2	133	-8.7	-3.4	-19.8	-3.7	12.3	96	14.5	6.8	6.9	5.5
Nominal external interest rate (in percent)	2.9	3.0	3.4	3.4	3.0	3.1	0.3	29	2.8	2.8	2.8	2.7
Growth of exports (US dollar terms, in percent)	-2.8	16.1	8.9	-5.4	-8.0	1.0	12.4	34.1	0.9	0.5	1.6	3.8
Growth of imports (US dollar terms, in percent)	-16.3	14.7	14.6	0.6	-15.5	0.4	15.4	165	8.2	5.0	5.5	5.1
Current account balance, excluding interest payments	-0.3	-0.1	-1.5	-2.3	-0.2	-1.7	1.2	15	-0.1	-1.0	-1.6	-1.9
Net non-debt creating capital inflows	3.9	2.6	3.8	2.4	3.1	3.3	0.6	3.6	3.4	3.5	3.4	3.2

1/ Derived as $(r - g - r(1+g) + ea(1+\alpha))/(1+g+r-g)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms; g = real GDP growth rate; e = nominal appreciation (increase in dollar value of domestic currency); and α = share of domestic-currency denominated debt in total external debt.2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)]/(1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

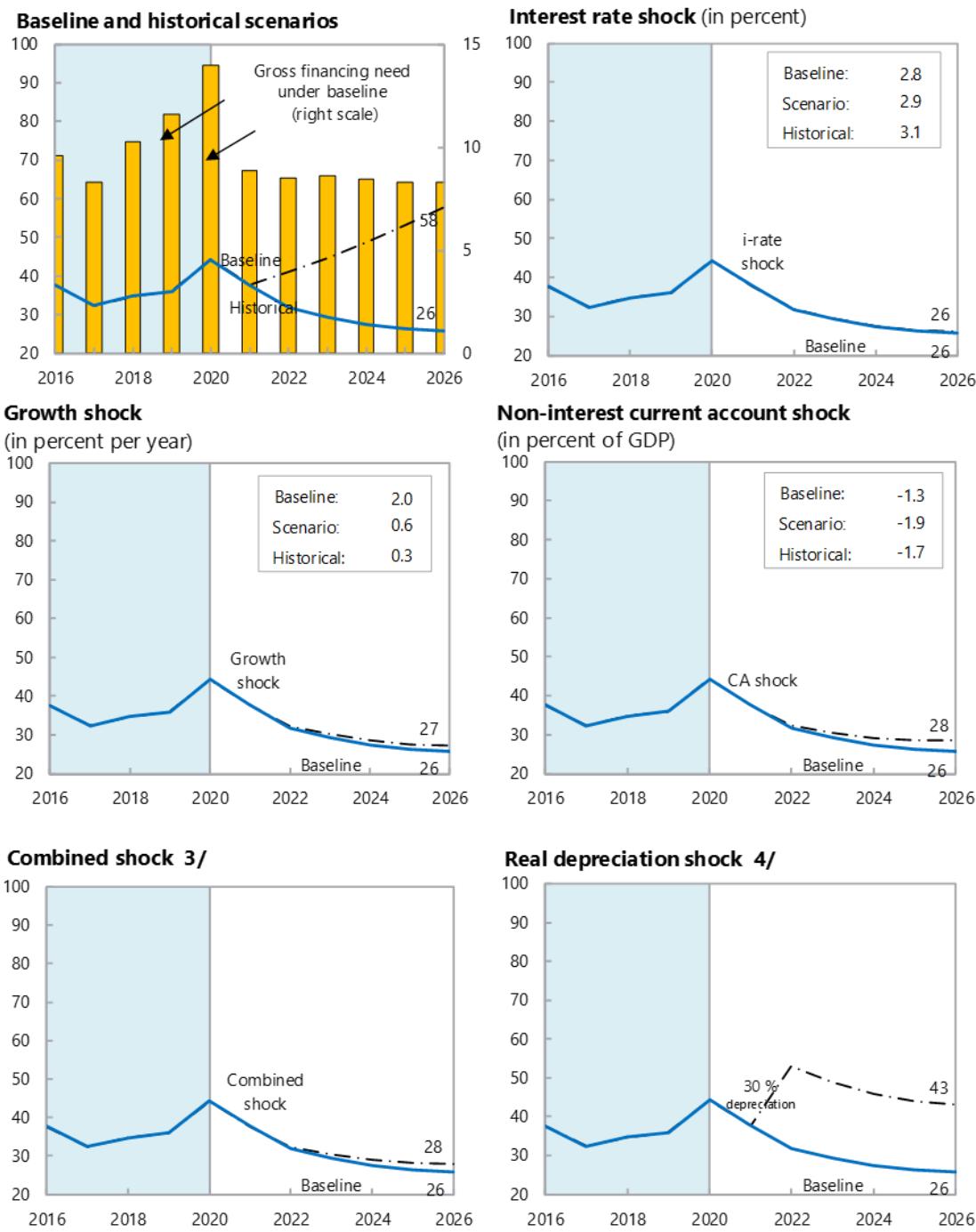
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. Brazil: External Debt Sustainability: Bound Test 1/2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent.

Annex III. Risk Assessment Matrix¹

Source of Risks	Relative likelihood	Expected Impact on Economy	Policy responses
Domestic risks			
Unexpected shift in the COVID-19 pandemic. Limited access to, and longer-than-expected deployment of, vaccines—combined with dwindling policy space—prompt a reassessment of growth prospects.	Medium	High. Growth dips further, wiping out years of progress in poverty and inequality, possibly resulting in social unrest. Financial markets reassess real economy risks leading to a repricing of risk assets, capital outflows, depreciation and inflation pressures.	The central bank should remain accommodative and limit FX intervention to disorderly market conditions. The government should reiterate its commitment to fiscal sustainability, while stepping up support to the health system as necessary.
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause economic hardship (including unemployment, higher incidence of poverty, and shortages and higher prices of essentials) and exacerbate preexisting socioeconomic inequities.	High	High. Both the recovery and fiscal consolidation are delayed causing a loss of market confidence and an increase in sovereign yields. Public debt and gross financing needs rise sharply undermining debt sustainability.	Social assistance spending and unemployment support would need to be extended and improved in their targeting. To restore market confidence, the government should provide clear forward guidance about medium term fiscal consolidation plans and frontload measures necessary to comply with the constitutional spending ceiling in the medium term. Monetary policy should stay accommodative.
Sharp rise in global risk premia exposes financial and fiscal vulnerabilities. A reassessment of market fundamentals triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to cascading debt defaults.	Medium	High. Higher risk premia generate financing difficulties for leveraged firms and households, and a wave of bankruptcies erode banks' capital buffers. Financing difficulties extend to the sovereign, unmasking debt-related vulnerabilities, and exacerbating debt sustainability risks.	The central bank should provide additional stimulus and liquidity support to the financial sector. Social assistance spending and unemployment support would need to be extended, resulting in a smoother fiscal consolidation.
External risks			
Accelerating de-globalization. Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation.	Medium	Low. Reshoring and less trade reduce potential growth. Nonetheless, the effects would be contained given that Brazil is relatively closed and may benefit from trade diversion effects.	Implement structural reforms (financial sector, tax, labor, etc.) and trade liberalization to boost potential growth.
Oversupply and volatility in the oil market. Higher supply and lower demand lead to renewed weakness in energy prices. Uncertainty about production cuts, prospects for the shale gas industry, and the pace of demand recovery lead to bouts of volatility.	Medium	Low. Low and volatile oil prices lead to subdued investment spending, primarily by Petrobras, further compressing investment and growth.	Given adverse debt dynamics, fiscal policy cannot provide stimulus. Liquidity support targeted to the energy sector could be appropriate, on the back of continued monetary policy accommodation. Structural reforms and trade liberalization would boost growth.
Intensified geopolitical tensions and security risks. (Geo)political tensions in selected countries/regions cause economic/political disruption, disorderly migration, higher volatility in commodity prices (if supply is disrupted), and lower confidence.	High	Medium. Lower confidence could increase risk aversion against EMs and result in capital outflows and depreciation pressures. However, higher commodity prices would benefit Brazil's terms of trade and partly offset the ER depreciation.	Outflow pressures should be either tolerated or addressed with macro-policy adjustments. The central bank should limit FX intervention to disorderly market conditions. Some tightening of existing CFMs on outflows in line with the Fund's Institutional View could be considered as part of a comprehensive package of policies in (imminent) crisis circumstances.

¹ 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.

Annex IV. Public Debt Sustainability Analysis

Using a wide range of analyses, debt sustainability risks are assessed to be moderate. Gross debt of the non-financial public sector (NFPS) jumped to 99 percent of GDP in 2020, substantially higher than the average of EM peers. Gross financing needs stand at close to 25 percent of GDP, also a high level for an emerging market. But the overwhelmingly domestic investor base, large liquid assets and substantial Central Bank holdings of Treasury debt mitigate rollover risks. Under the baseline scenario, public debt is projected to drop sharply in 2021, reverting around two-thirds of the increase in 2020, before stabilizing at 92 percent of GDP over the remainder of the forecast horizon. The trajectory of the debt-to-GDP ratio is highly sensitive to shocks to real GDP growth, fiscal deficits, and borrowing costs.

Background

1. Definitions and coverage. The gross debt statistics of Brazil cover the NFPS, excluding the state-owned enterprises (SOEs) Petrobras and Eletrobras, and consolidate the Sovereign Wealth Fund. Following the GFSM 2014 manual, the NFPS debt includes all Treasury securities on the Central Bank's (BCB) balance sheet.¹ As reported by the government, net debt corresponds to the public sector (PS), which includes consolidation with the BCB. Brazil's debt is reported at nominal value.²

2. Debt developments. At end-2020, Brazil's NFPS gross debt amounted to 98.9 percent of GDP, 11.3 percentage points higher than a year before. The consolidated public sector net debt amounted to 62.7 percent of GDP at end-2020, reflecting a large stock of assets, equal to 31.3 percent of GDP, which included international reserves amounting to 19.5 percent of GDP. A large primary deficit of 9.2 percent of GDP and an interest – growth differential of 6.4 percentage points (driven by the contraction in real GDP), caused the increase in gross debt. Use of liquid assets of 3.7 percent of GDP avoided an even larger increase. Despite the jump in debt levels, gross interest payments of the NFPS and net interest payments of the consolidated PS stood at 6.1 and 4.1 percent, respectively, the lowest level since 2013 due to record low interest rates.

3. Debt profile (text table). Federal government (FG) debt accounts for 94 percent of total NFPS debt (states and municipalities have significant debt but most of it is with the federal government). Domestically issued securities account for 96 percent of total FG gross debt. Around 27 percent of domestically issued securities are held by the BCB - issued specifically to the Central

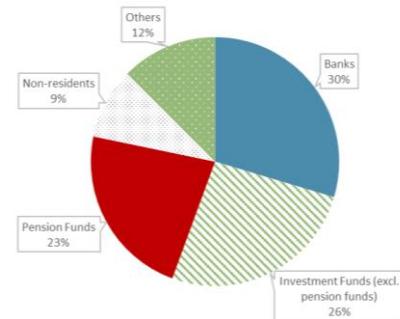
¹ In contrast, the authorities' definition of gross debt includes the stock of Treasury securities used for monetary policy purposes by the BCB (those pledged as security in reverse repo operations) but excludes the rest of the government securities held by the BCB. Thus, per the national definition, gross debt of the general government amounted to 88.8 percent of GDP at end-2020. The definition of net debt is the same between the authorities and the IMF.

² The nominal value is calculated as the PDV of future interest and principal payments at the security's contractual interest rate(s), and generally differs from face value.

Bank for the conduct of monetary policy – and are never traded.³ Only around 9 percent of domestic tradable securities are held by non-residents, with domestic banks the largest holders and also the key buyers during 2020, increasing their share from 24.7 to 29.6 percent. 37 percent of FG domestic tradable securities are linked to the SELIC rate, 36 percent are fixed rate securities, and 27 percent are linked to inflation.⁴

Average duration of FG securities issued during several months in 2020 was as low as 2-2.5 years as the share of short-term debt (below 12 months) accounted for one-third of all issuances in 2020 (Box 1). About 27 percent of FG domestic tradable securities will mature in 2021 alone. Foreign currency denominated NFPS debt accounted for only 6 percent of GDP at end 2020, marginally up due to the large exchange rate depreciation.

Holders of Domestic Tradable Federal Government Securities



Brazil: Overview of Public Debt							
<i>Percent of GDP</i>	Total	Held by Federal Government	Held by Banks	Held by Funds, Pension Funds and Insurers	Held by Nonresidents 1/	Held by Other	Held by the Central Bank
Federal Government Gross Debt	93%						
Issued to the market	67%						
Domestically issued	64%						
Fixed rate	23%						
Floating rate	23%						
Inflation-linked	17%						
FX-linked	0%						
FX debt	3%						
Issued to the Central Bank	26%						26%
Used in reverse repos by CB	17%						
Overnight	11%						
Free portfolio of the CB	9%						
Bank and other debt	0%			0%			
Subnational Government Gross Debt	14%	8%	3%		2%		
SOE Gross Debt	1%	0%	0%		0%		
NFPS Gross Debt (not consolidated)							
NFPS Gross Debt (consolidated)	99%						
Total NFPS Assets (consolidated)	31%						0%
of which fully liquid treasury deposits at the CB	12%						
of which illiquid assets	19%						
other deposits at the CB	8%						
credit to public fin. Institutions	3%						
other	9%						0%
NFPS Net Debt	68%						
NFPS Debt Net of Liquid Assets	87%						
Public Sector Gross Debt (consolidated)	101%						
Public Sector Assets (consolidated)	38%						
of which international reserves	25%						0%
Public Sector Net Debt	63%						25%
Memo:							25%
Average Duration Federal Government Debt	3.57						
Average Maturity Federal Government Debt	4.83						
Nominal GDP (billions of Reais)	7,448						

1/ For FX debt of the federal government, assume held by nonresidents

³ At end-2020 the BCB used about two-thirds of its holdings as security in liquidity-draining reverse repo operations with the banking system.

⁴ A residual 0.5 percent are exchange rate linked securities.

Baseline and Realism of Projections

4. Macroeconomic assumptions. The projections assume real GDP growth of 5.3 percent in 2021 followed by growth of 1.9 percent in 2022. Medium-term growth is projected at 2.1 percent. The NFPS primary balance is projected to move to a small surplus by 2024, with a cumulative adjustment of about 3 percentage points of GDP over 2021–26 and a large adjustment of 7.5 percentage points in 2021, unwinding most of the 2020 widening of 8.3 percentage points. Nominal interest rates on new borrowing are substantially lower than in the past due to a record-low policy rate but are projected to increase somewhat again as monetary policy normalizes. The effective nominal interest rate is projected at 6.6 percent in 2021, relative to an average of 11.4 percent over 2010–18, 8.4 percent in 2019 and 7 percent in 2020.

5. Baseline debt projection. In the baseline scenario, gross debt to GDP falls significantly in 2021 given the reduction in the primary balance and highly favorable $r-g$. Debt is expected to be broadly stable between 2022–26. The debt stabilizing primary balance in the baseline scenario is 1.1 percent of GDP, relative to a projected surplus of 1.2 percent of GDP in 2026. Net debt of the consolidated public sector is expected to increase throughout the projection horizon because international reserves are assumed to be broadly constant in nominal terms, thus falling relative to GDP.

6. Baseline gross financing needs projection. Gross financing needs declined from close to 18 percent of GDP in 2015 to 14 percent in 2019. They increased substantially in 2020 to 24 percent of GDP.⁵ Financing needs are projected to drop marginally in 2021 to 23.2 percent of GDP before averaging close to 20 percent per year over the remainder of the forecast horizon, thus breaching the high-risk threshold of 15 percent of GDP (Figure 3). This indicator, however, overstates the financing risks since amortization payments would be about 25 percent lower on average excluding the automatic rollover of BCB held bonds. In line with the authorities' debt management strategy, the DSA assumes that short term issuances will drop sharply in 2022. Two-year fixed and floating rate bonds will remain an important source of financing in 2022 but then also drop in 2023 with average maturities increasing.

7. Fan chart analysis. In the baseline, debt stabilizes in 2022 but the path is highly sensitive to the real interest rate, growth, and the speed of fiscal adjustment. A negative combination of macroeconomic variables at the 10th percentile would yield debt over 110 percent of GDP in 2026 and on a steep upward trajectory (fan charts in Figure 1). In the most optimistic scenarios, positive shocks could lower public debt to below 80 percent of GDP (10th percentile of positive outcomes). The asymmetric fanchart in the Sovereign Risk and Debt Sustainability Framework suggests a high probability of at least stabilizing debt at around 80 percent by 2026.

⁵ The authorities made use of their cash deposits at the Central Bank as a financing tool in 2020. Given the extensive use of the treasury single account for financing in 2020 (which was accompanied by reverse repo operations of the Central Bank to reduce excess liquidity) the "free portfolio" of Treasury debt held by the BCB fell significantly in 2020, reducing the gap between the authorities' and the IMF's definition of debt to the lowest level in many years in mid-2020. With issuances exceeding financing needs in late 2020 and early 2021 this has partially reversed.

8. Past forecast error. Forecast errors for GDP growth are larger than those in surveillance countries during 2014–16, reflecting the fact that Brazil underwent its largest recession in a century (pre-COVID) during 2015–16 (Figure 2).

9. Realism of projections. Brazil's projected fiscal adjustment is in the tail of the historical distribution. The level of the PB over the forecast horizon, however, is in line with other surveillance countries' experience (Figure 2).

10. Contingent risks from systemic SOEs. The government holds about 50 percent of Petrobras' and Eletrobras' shares, both of which are excluded from the debt definition. Fiscal risks could arise from possible future capitalizations to cover losses. However, Petrobras's financial position improved substantially in recent years with net debt/EBITDA falling continuously. Looking forward, and especially if oil prices remain favorable, Petrobras is well positioned to benefit from the growth of pre-salt exploration and further sales of non-core subsidiaries. Political interference in the day to day management of the company poses a potential risk, however. The government has taken concrete steps to privatize Eletrobras and it will likely cease to be a publicly owned company in the near-term. Overall, the fiscal risks arising from Petrobras and Eletrobras are deemed limited at this point.

11. Primary balance shock. The primary balance shock assumes an average worsening of the primary balance of 1 percent of GDP over 2022–2026. Debt enters an upward path, reaching close to 100 percent of GDP in 2026.

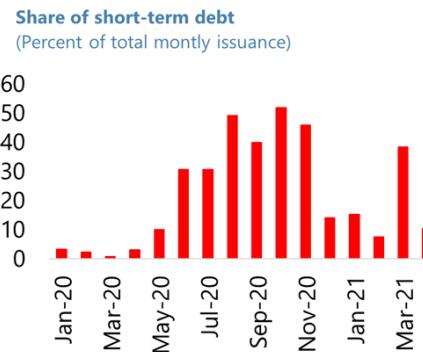
12. Growth shock. Under the growth shock scenario, real output growth is reduced by one standard deviation (2.8 percentage points) for two consecutive periods starting in 2022. Under this scenario, gross debt jumps to close to 105 percent of GDP by end-2022 and continues to increase at a slower pace thereafter.

13. Real interest rate and real exchange rate shocks. In the real interest rate shock scenario, the effective rate increases to over 10 percent by 2026. In the real exchange rate shock scenario, the nominal exchange rate depreciates by 47 percent (maximum movement over the past 10 years) in 2021 and appreciates only marginally thereafter. Under the real interest rate shock, gross debt enters a steep upward path towards 105 percent of GDP in 2026. Such a scenario could result from a de-anchoring of inflation expectations, linked possibly with an additional increase in the risk premium. The impact of the real exchange rate shock is modest, all else equal, given the low share of FX debt.

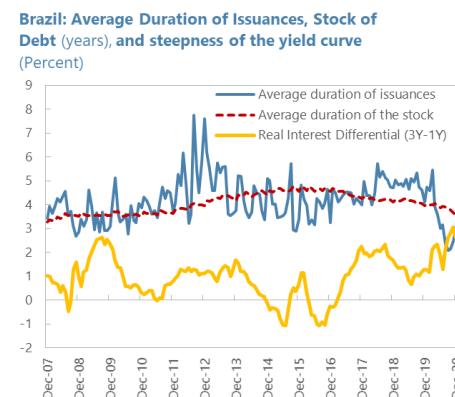
14. Combined macro-fiscal shock. The macro-fiscal shock combines the real growth, interest rate, exchange rate and the primary balance shocks as described above. The impact of the macro-fiscal shock on gross debt-to-GDP is extreme. Gross debt exceeds 120 percent by 2026, with gross financing needs consistently around 25 percent of GDP.

Box 1: The Role of Short-Term Debt Issuances in Bridging the Crisis

With financing needs increasing sharply in 2020, the Treasury has relied on short-term issuances. The Treasury has been relying on 6-12 month paper to bridge the crisis to an even larger degree than during the 2015-16 crisis. While short-term debt accounted for 12 percent of all domestic market issuances in 2016 (and an average of 5 percent over 2017-19), this rose to 30 percent in 2020. Since December 2020 the share of short-term issuances has dropped again amid improved market conditions even as the total volume of issuances remains high.

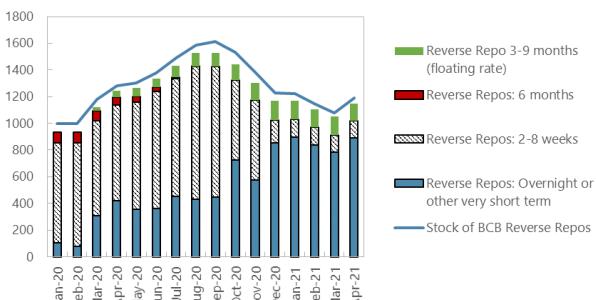


The average duration of the stock of debt fell back to 2011 levels. Average duration had been rising until 2015 in line with the Treasury's long-term debt management plan before falling since then to 4 years in early 2020 and to 3.6 years in March 2021. At 4.8 years, the average maturity of debt is somewhat lower than the OECD EM country average but broadly in line with other sovereigns with a comparable credit rating. From a pure cost perspective, the underlying opportunity cost of shortening was low in 2020 as the steepness of the real yield curve hit a long-term high.¹



The average maturity of the central bank's reverse repos also fell sharply in late 2020. The BCB adjusted the profile of its reverse repos, increasing the share of overnight operations from 10 percent in January 2020 to over 70 percent in March and April 2021. A likely motivation was to avoid competition with shorter-dated Treasury securities.

Outstanding BCB Reverse Repos (bn Reais)



Source: Haver and IMF Staff Calculations

¹ Bai, Kim and Mihalache "The Maturity and Payment Schedule of Sovereign Debt" (2015) shows how shortening maturities during recessions can yield an optimal trade-off between consumption smoothing and endogenous borrowing costs and that Brazil has optimally done so in the past.

Figure 1. Brazil: Public DSA—Risk Assessment**Heat Map**

Debt level ^{1/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs ^{2/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile ^{3/}	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

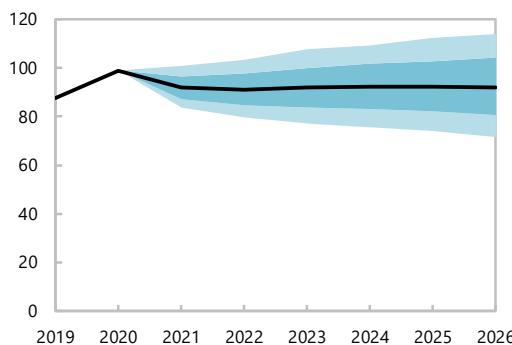
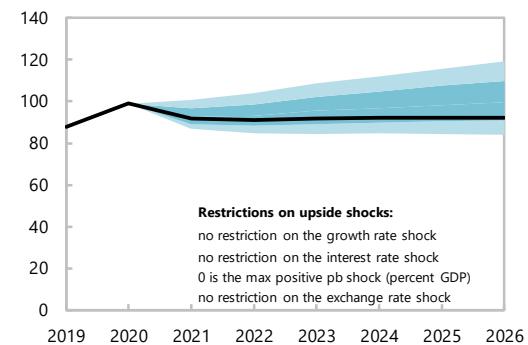
Baseline

Percentiles:

10th-25th

25th-75th

75th-90th

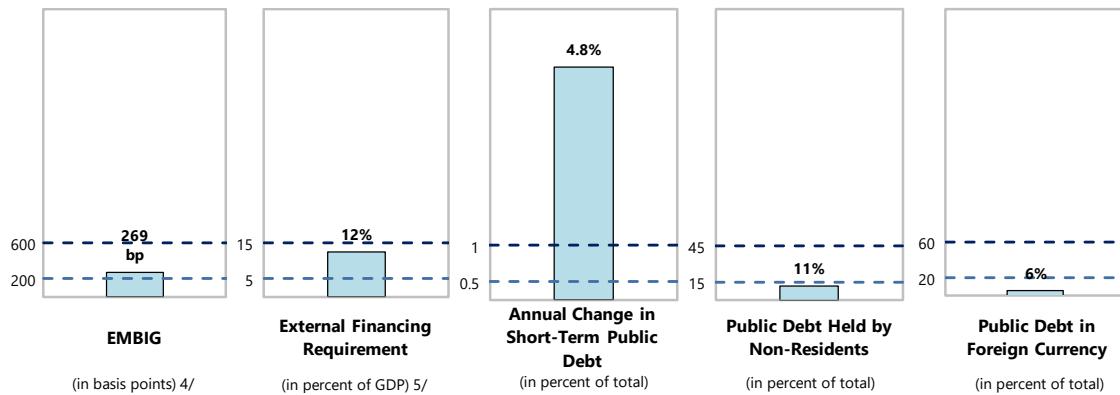
Symmetric Distribution**Restricted (Asymmetric) Distribution****Debt Profile Vulnerabilities**

(Indicators vis-à-vis risk assessment benchmarks, in 2020)

Brazil

— Lower early warning

--- Upper early warning



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

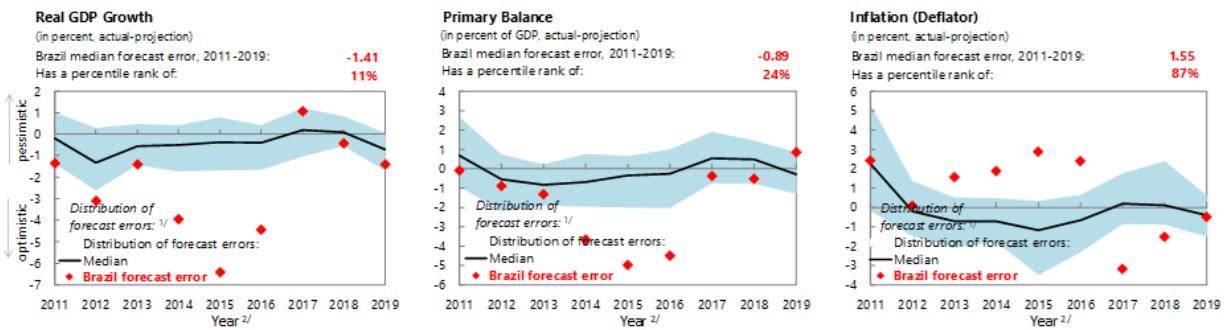
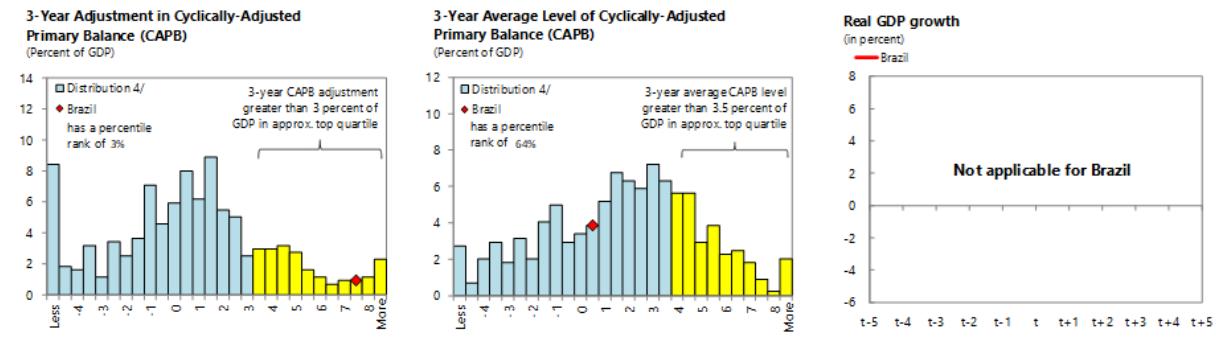
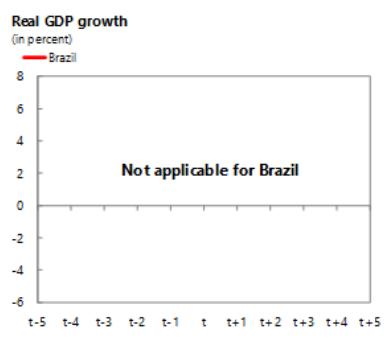
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 30-Jan-21 through 30-Apr-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 2. Brazil: Public DSA—Realism of Baseline Assumptions**Forecast Track Record, versus all countries****Assessing the Realism of Projected Fiscal Adjustment****Boom-Bust Analysis^{3/}**

Source: IMF Staff.

1/ Potted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Brazil, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 3. Brazil: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

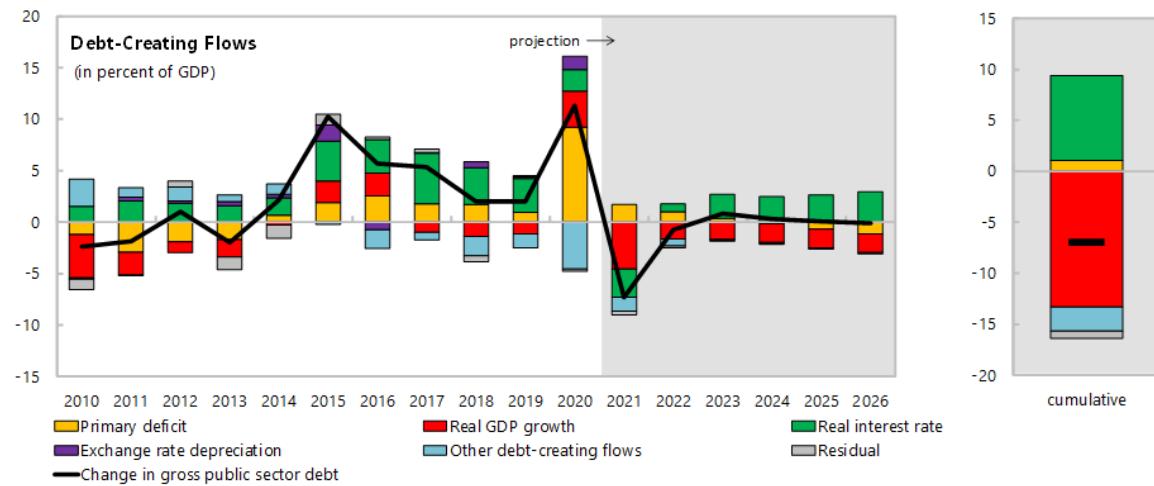
(Percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators^{1/}

	Actual			Projections						As of April 30, 2021		
	2010-2018 ^{2/}	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads	EMBIG (bp) ^{3/}	260
Nominal gross public debt	69.9	87.7	98.9	91.6	90.9	91.7	92.0	92.1	92.0	5Y CDS (bp)	214	
Public gross financing needs	13.4	14.0	24.1	23.2	20.3	22.7	20.5	18.6	15.3	Ratings	Moody's	Ba2
Net public debt	39.3	54.6	62.7	63.9	66.4	69.4	71.8	72.6	74.6	S&Ps	BB-	BB-
Real GDP growth (in percent)	1.5	1.4	-4.1	5.3	1.9	2.0	2.1	2.1	2.1	Fitch	BB-	BB-
Inflation (GDP deflator, in percent)	7.1	4.3	4.8	9.3	5.7	4.1	4.2	4.0	3.9			
Nominal GDP growth (in percent)	8.7	5.8	0.6	15.0	7.8	6.1	6.4	6.2	6.1			
Effective interest rate (in percent) ^{4/}	11.4	8.4	7.0	6.6	6.8	6.9	7.1	7.2	7.4			

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026		
Change in gross public sector debt	2.2	2.0	11.3	-7.3	-0.7	0.8	0.3	0.1	-0.1	-7.0	1.1
Identified debt-creating flows	2.5	1.9	11.5	-7.0	-0.6	0.9	0.4	0.1	-0.1	-6.2	
Primary deficit	0.1	0.9	9.2	1.7	1.0	0.3	-0.2	-0.7	-1.2	1.0	
Primary (noninterest) revenue and grants	31.2	29.6	27.4	28.7	28.3	28.3	28.4	28.4	28.4	170.5	
Primary (noninterest) expenditure	31.2	30.5	36.6	30.4	29.3	28.7	28.2	27.7	27.2	171.5	
Automatic debt dynamics ^{5/}	2.2	2.3	6.9	-7.3	-0.8	0.6	0.6	0.8	1.1	-4.9	
Interest rate/growth differential ^{6/}	1.9	2.1	5.7	-7.3	-0.8	0.6	0.6	0.8	1.1	-4.9	
Of which: real interest rate	2.7	3.3	2.1	-2.7	0.8	2.3	2.4	2.7	2.9	8.4	
Of which: real GDP growth	-0.8	-1.1	3.5	-4.5	-1.6	-1.7	-1.8	-1.8	-1.8	-13.3	
Exchange rate depreciation ^{7/}	0.3	0.2	1.2	
Other identified debt-creating flows	0.2	-1.4	-4.6	-1.4	-0.7	-0.1	-0.1	-0.1	-0.1	-2.4	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General Government Net Acquisition of Financial Assets	0.2	-1.4	-4.6	-1.4	-0.7	-0.1	-0.1	-0.1	-0.1	-2.4	
Residual ^{8/}	-0.2	0.1	-0.2	-0.3	-0.2	-0.1	-0.1	0.0	0.0	-0.7	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year. Interest payment forecasts on existing debt do not adjust for FX movement.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+i)) / (1 + g + \pi + gt)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+i)$.

8/ Includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 4. Brazil: Public DSA—Composition of Public Debt and Alternative Scenarios
Composition of Public Debt

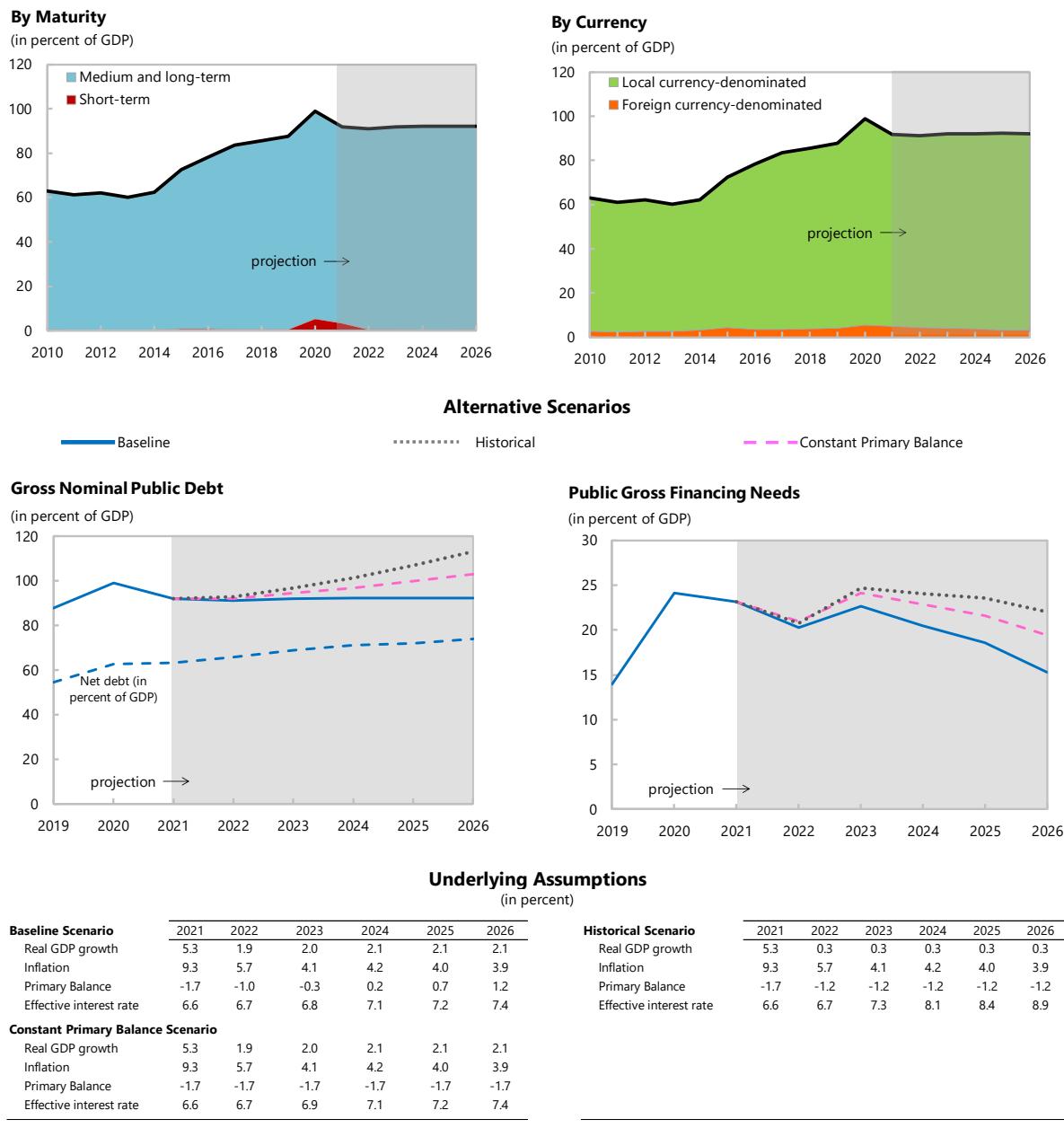
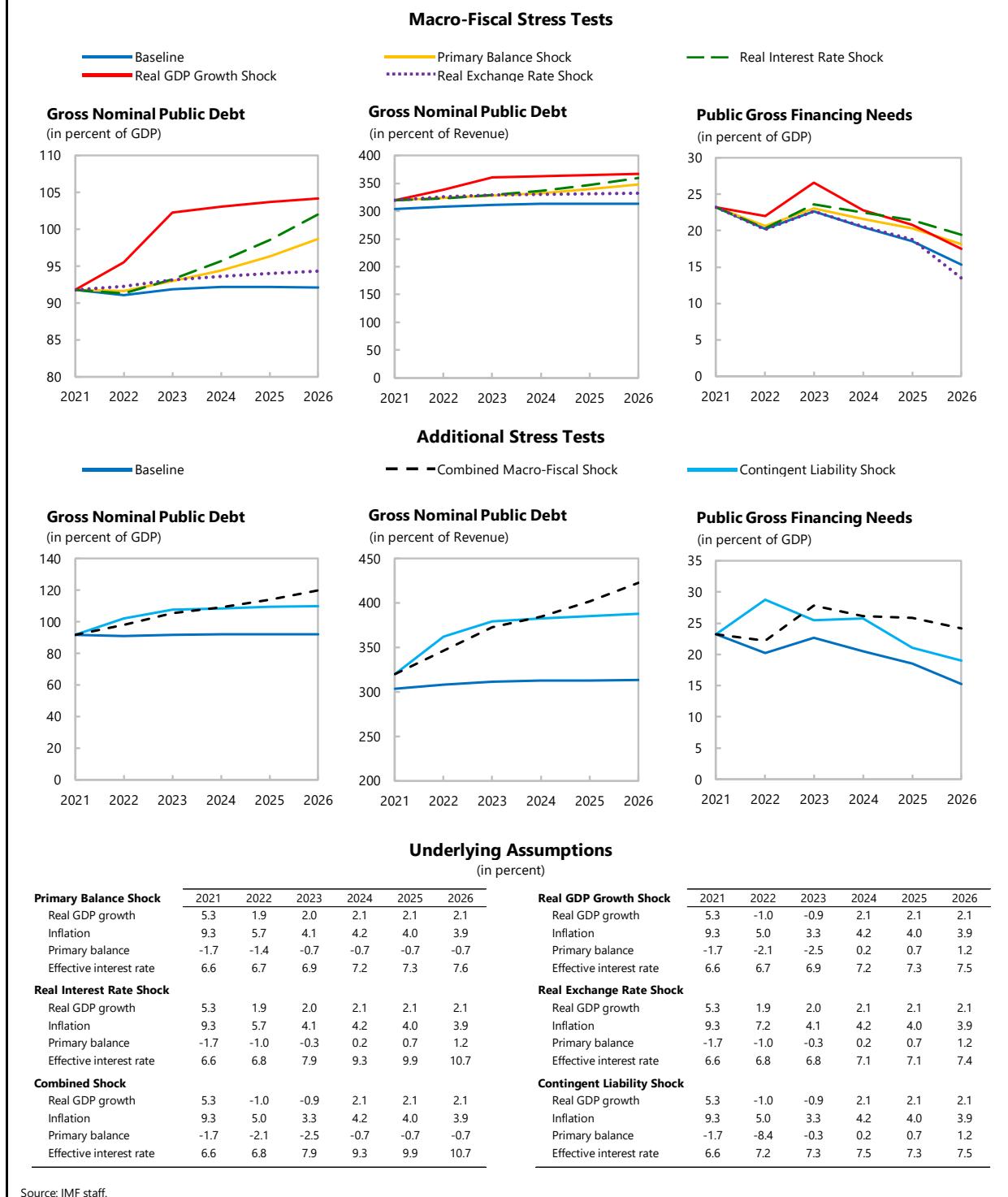


Figure 5. Brazil: Public DSA—Stress Tests

Source: IMF staff.

Annex V. Implementation of Key FSAP Recommendations¹

Brazil: Key FSAP Recommendations		
Recommendations	Time	Authorities' Actions
Microprudential and macroprudential 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 (Short Term)	The BCB has – in agreement with CVM, Previc and SUSEP – finalized a draft bill named the “Financial Stability Coordination Law”, which is now being discussed with the Ministry of Economy.
Strengthen the crisis management institutional arrangements for inter-agency cooperation and exchange of information, including for contingency planning.	MT (Medium Term)	This proposal is directly related to the above-mentioned “Financial Stability Coordination Law”. According to the draft bill proposed by BCB, the “Financial Stability National Committee” would have authority over macroprudential policy and crisis management (including contingency plans/crisis management). The BCB’s Contingency Plan 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>Two bills of law that tackle BCB autonomy were under discussion in Congress. One bill has been approved by Congress and addresses the Central Bank mandate, including the criteria for the appointment and the dismissal of Governors, and sets four-year tenures (with one renewal) for the Board of Governors. Their tenures do not match the presidential term to avoid a wholesale change whenever a President is elected.</p> <p>The approved law also includes several features of the second bill (which is no longer under consideration), such as 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 of BCB staff which had been included in the second bill. The Bank Resolution bill – submitted to the lower house and currently being discussed by a special congressional committee – also provides for protection of public agents. As it stands, this bill includes both a provision for legal protection of public agents and for legal defense by the General Counsel on BCB expenses.</p> <p>The insurance supervisor (SUSEP) Board has drafted a bill to merge SUSEP with the pension funds supervisor (Previc), addressing, among other issues, the structure of the new authority. This draft bill has not yet been approved by Congress. However, it is worth noticing that the Decree nº 9.727/2019 has established qualification criteria for appointments to strategic positions in the Administration.</p>
Increase resources of CVM and SUSEP.	ST	The CVM budget was reduced to R\$ 22 million during 2019 from R\$ 30.5 million at the beginning of the year. The total discretionary budget for 2020 was R\$ 27.7 million. The budget for 2021 currently amounts to R\$ 26 million.

¹ The description of authorities’ actions in this table was compiled by the Brazilian authorities.

Brazil: Key FSAP Recommendations (Continued)		
Recommendations	Time	Authorities' Actions
		Notwithstanding the studies underway to merge and restructure SUSEP and PREVIC, budget constraints, throughout the Federal Government currently impose limits to any proposal in this regard.
Increase resources of CVM and SUSEP.	ST	<p>The CVM budget was reduced to R\$ 22 million during 2019 from R\$ 30.5 million at the beginning of the year. The total discretionary budget for 2020 was R\$ 27.7 million and the expected budget for 2021 was R\$ 31.3 million.</p> <p>Notwithstanding the studies underway to merge and restructure SUSEP and PREVIC, budget constraints, throughout the Federal Government currently impose limits to any proposal in this regard.</p>
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 our supervisory methodology. The Structured Add-on is in its third year of application to all banks (segments from S1 to S4). The Add-on by Reference is applied to banks allocated to Segment S1 and includes metrics for credit concentration risk and IRRBB since 2020. Technical studies to include Banks allocated to S2 Segment in Add-on by Reference process are scheduled.
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 already been completed:</p> <p>(i) The National Monetary Council (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) was adapted to include information on large exposure limits; (ii) The CMN issued Resolution 4,693/2018 addressing credit operations between related parties; (iii) The BCB issued Circular Letters 3,819/2017 and 3,857/2017 on reporting requirements of restructuring of financial instruments, applicable to all financial institutions since May 2018.</p> <p>For the current resolution (Res 4,693 of Oct / 18), accounting items were created to collect information from Related Parties (data from Jan / 19), in which financial institutions will report the greatest exposure to related parties (natural person and legal entity) and other exposures with related parties (natural person and legal entity). A field was also included in the SCR (as of Jan / 19) to inform whether the contracted operation is being carried out with related parties.</p> <p>A number of other initiatives are under analysis or being drafted:</p> <p>(i) Regulation on prudential treatment for transactions with related parties.</p> <p>(ii) Amendment to the regulation establishing specific requirements for country and transfer risks, with specific treatment of indirect risks.</p>

Brazil: Key FSAP Recommendations (Continued)		
Recommendations	Time	Authorities' Actions
		(iii) Requirement of producing concentration risks data on a regular basis. (iv) Structured assessment of country, transfer and indirect risk (v) IFRS9 implementation, which will enhance the credit risk framework definitions, including the definition of credit risk exposure.
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 industry) will be affected. A new version of this agreement was adopted in the first half of 2021. On regulation, CVM Instruction 607 was issued to regulate the new Law that expanded the CVM's enforcement power. That is, the new regime is totally applicable and in effect.
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 granular data sharing depends on legal provisions and on the establishment of partnerships among the supervisors. In the BCB's view, 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 the National 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	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. 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 current BCB capital structure is public (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. Implementation of new permanent liquidity facilities is undergoing, and that project is in the BC# Agenda, with a deadline in November 2021.
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 process to establish the "Financial Stability National Committee" is ongoing. The BCB has signed a MoU with the FGC to grant access to detailed information on financial institutions that are members of the FGC, in order to facilitate the Fund's 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.

Brazil: Key FSAP Recommendations (Continued)		
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 on March 6, 2020.
Financial intermediation efficiency		
Foster competition through client mobility and financial product cost transparency and comparability.	ST	<p>The National Monetary Council issued Resolution 4,639/2018 to enhance the portability of salaries' accounts.</p> <p>The Credit Registry Law, Lei do Cadastro Positivo, in effect since 2011, was amended by Lei Complementar 166/2019, and regulated by Resolution 4,737/2019, to adopt the opt-out model instead of the 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>The set of credit modalities eligible for portability between institutions now comprises credit granted to individual microentrepreneurs (before restricted to individuals). Resolution 4,762/2019 already allows credit portability for legal entities, but it depends on enacting a specific rule (Circular). Additionally, different credit modalities can be the destination of ported credit, providing a larger menu of options to financial customers. This allows, for instance, the portability of revolving credit operations into personal credit lines, with a fixed number of installments. It might foster the contribution of new entrants and incumbent institutions that do not operate with the original credit modality to a greater competition in the Brazilian credit market.</p>
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 December 2019, BNDES launched a new planning and communication tool for strategic agendas and deliveries: the 2020-2022 three-year plan. This is based on three main pillars: financial sustainability, focus on social development and divestments of the equity portfolio.</p> <p>In terms of financial sustainability, with the Long-Term Rate (TLP) in force and its market convergence from 2023 forward, and a deleveraging policy of continued prepayments of the loans from the National Treasury, the bank has been structured to seek new funding alternatives. This policy also includes developing strategies for syndication of transactions, bringing in more players to fund the projects alongside BNDES, as well as adjusting its loan agreements in order to allow securitization in the future.</p> <p>BNDES started divestments in 2019, in a very cautious manner in order to reduce its risk limit by 90% up to December 2022. In 2020 from January to September, BNDES has divested around R\$33.7 billion in equity positions including, Petrobras (R\$ 22 billion) and Vale (R\$ 8.1 billion).</p>

Brazil: Key FSAP Recommendations (Continued)		
Recommendations	Time	Authorities' Actions
		<p>Regarding FAEP, the provisional act has lapsed without approval of Congress. Nevertheless, BNDES is still focused and committed to support the States and Municipalities in their privatization efforts, providing project preparation services in all modalities, including concessions, public-private partnerships (PPP) and privatizations, and sharing knowledge with the public sector. As of September 2020, there were 74 projects being structured by BNDES in its portfolio: 31 federal, 30 state and 13 at municipal level in several sectors such as water and sanitation, ports, highways, street lighting, power distribution among others. Successful auctions have occurred in the sanitation sector, with the participation of many private players in the bidding process, and the major part of the portfolio is expected to be auctioned by 2022.</p> <p>Strategic guidelines for this topic include contributions to the financial sustainability of the entities in the Federation, promoting regulatory security for leverage investments and competitive auctions, and supporting the public sector in structuring long-term partnerships to make feasible private investments in projects of public interest. The bank is also stimulating the opening of the Brazilian infrastructure market, promoting the entry of new national and international players, including operators and financial investors.</p> <p>Regarding the capital markets initiatives, in the second semester of 2019 Fund Manager for the Infrastructure Bonds Special Purpose Vehicle (FDIC Debêntures de Infraestrutura) was selected. However, due to the interest rate curve structure in 2020, the fund is currently not active.</p> <p>(ii) On the other hand, the Sustainable Energy Fund, launched in 2016 and implemented in 2018, with assets under management of R\$500 million in infrastructure projects private bonds related to a low-carbon economy, is currently in its investment phase. Since it was launched over 50 primary investment opportunities for the Fund's portfolio have been analyzed, resulting in the subscription of 12 different project debentures. The annual return over September 2019-September 2020 was 19.4% and the annual volatility over the same period was 3.95% per year. The fund's annualized return, from Sep / 2018 to Dec / 2019, was 18.85% per year.</p> <p>(iii) A new and relevant initiative in the Brazilian Capital Markets was launched in May 2020: an RFP process for the selection of FDICs for SMEs as one of the emergency measures to support SMEs during the COVID crisis. The Bank pre-selected 12 FDICs, of which 10 will receive funds up to R\$ 5 billion to offer credit for small businesses, helping to diversify the fund sources and improve access to credit.</p>
Focus Caixa on core activities, improve governance, and invite a strategic investor.		<p>Focus Caixa on core activities:</p> <p>CAIXA is repositioning its credit operations, prioritizing the granting of loans to the segments linked to microenterprises, to the promotion of housing loans, maintaining its operations in "Minha Casa Minha Vida" and expanding operations to the middle class through resources from savings and increase in the payroll loans portfolio.</p> <p>Improve governance:</p> <p>CAIXA continues to improve its corporate governance practices, seeking to become a reference in the adoption of good management strategies, in line</p>

Brazil: Key FSAP Recommendations (Concluded)		
Recommendations	Time	Authorities' Actions
		<p>with principles such as transparency, equal treatment, accountability, corporate social responsibility, compliance, strategic risk management and sustainability.</p> <p>Caixa has been updating its corporate governance model, primarily through changes in its bylaws. This has included the creation of a clause that limits its action to achieve the public interest, constitution of a management succession plan, enlargement of the number of directors and constitution of a people committee, among others. In addition, the equity governance for operation in a Conglomerate has been improved.</p> <p>Invite a strategic investor:</p> <p>Since 2019, Caixa has, through its subsidiaries, entered into 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 multidisciplinary talented professional, aiming to expand the Bank's pre-existing fixed income capital markets' operation and create a complete structure of investment bank products.</p> <p>Divestment:</p> <p>Aligned with its 2021 Business Plan, Caixa has focused monetizing assets and boosting operations aimed at the capital market. CAIXAPAR, a subsidiary of CAIXA, sold all its shares in Banco Pan to BTG Pactual in May 2021.</p>

Annex VI. Implementation of Past IMF Advice

<i>IMF Recommendations</i>	<i>Rationale</i>	<i>Implementation status</i>
Fiscal Policy		
Provide new (exceptional) fiscal support to the economy in 2021 if economic conditions are worse than the authorities expect.	Support the most vulnerable households and economic recovery. Minimize scarring effects on output.	As the second Covid-19 wave hit, slowing the recovery, emergency programs for vulnerable households, formal employment, SMEs, and health response were renewed. ●
Reducing mandatory spending (including wage bill) and budget rigidities (spending indexation, revenue earmarking, spending floors) through structural reform	Lock-in medium term consolidation, ensure compliance with the expenditure ceiling, free up fiscal space for more productive spending.	No reforms were approved which structurally reduce mandatory spending or budget rigidities, even though the 'Emergency' amendment foresees mandatory spending freezes under fiscal stress conditions. ●
Strengthen the social safety net by rationalizing inefficient and regressive programs, avoiding duplication.	Improve fairness, expand social assistance coverage without budget pressure.	No concrete steps were taken. Current plans focus on expanding the (well-targetted and cost-effective) <i>Bolsa Família</i> program. ●
Reform subnational pension schemes to align with federal government (FG) provisions, strengthen the subnational fiscal framework (lower debt limits, enhance fiscal transparency, simplify rules, limit spending growth)	Ensure fiscal sustainability and fairness; reduce FG bail-out expectations by SNGs.	Some states (e.g. Acre, Alagoas, Amazonas, Ceará, Espírito Santo, Mato Grosso do Sul, Paraná, Piauí, Rio Grande do Sul) reformed their pension systems in line with FG provisions. The 'Emergency' amendment creates new tools for SNG spending control in fiscal stress situations. ●
Revamp the tax system - simplify indirect taxation, increase PIT progressiveness, tax dividends.	Promote economic efficiency and fairness.	Congress continues discussions on the creation of a federal VAT (subnational taxes to be included at a later stage). An income tax reform bill has been submitted. ●
Remove distortionary tax exemptions.	Support fiscal sustainability and promote economic efficiency.	The 'Emergency' amendment foresees that the government presents a plan for reduction of tax expenditure in about 2 percent of GDP over 8 years. PIS/COFINS reform proposals in Congress would eliminate a small part of tax expenditures. ●
Further strengthen revenue administration to support creation of a unified VAT, enhance the taxpayer compliance framework, and simplify tax arrears collection	Support fiscal sustainability and promote economic efficiency.	Receita Federal has approved a number of institutional strategic projects for 2021-2023 with a view to implementing IMF past recommendations (Resolution No 41, June 10, 2021). ●
Move toward a medium-term budget framework.	Create fiscal space, protect social programs, and increase investment.	No concrete steps have been taken. ●
Pursue privatization of SOEs	Promote economic efficiency, support to fiscal consolidation efforts.	SOEs (Petrobras, BNDES) continue to sell assets. The new sanitation framework (approved in mid-2020) allowed for privatization of several subnational SOEs. Congress recently approved privatization of Eletrobras. ●
Release unused earmarked resources locked in public funds.	Alleviate financing pressures and amortize debt.	The 'Emergency' amendment freed up BRL 140 billion (1.7 percent of GDP) in previously earmarked government funds for use in debt management. An additional 70-100bn are likely to be freed up in the near future based on the same legislation. ●

IMF Recommendations	Rationale	Implementation status
Monetary and Financial Sector Policies 1/		
Legislate BCB's independence and legal protection of its staff.	Strengthen the inflation-targeting, micro-prudential, and safety net frameworks.	Central bank autonomy has been approved, with fixed-term mandates (staggered with the presidential mandate) for the governor and deputy governors. Legal protection of BCB staff hasn't been legislated. 
Maintain an accommodative policy stance. Ease further if inflation and inflation expectations remain below target.	Support return of inflation to target.	Loose monetary policy was kept through early 2021. The subsequent tightening cycle responds to persistently rising inflation and inflation expectations. 
Make permanent the 2020 reduction of the reserve requirement ratio (RRR) for time deposits.	Reduce banks' liquidity costs, helping narrow borrowing spreads, boost credit to firms and households.	The RRR, that was lowered from 32 to 17 percent in 2020, was previously set to be increased back to 25 percent in April 2021. It is now scheduled to be raised back to 21 percent in 2022. Additionally, the set of assets eligible for reserves will be broadened for 3 percentage points of the 21 percent. 
Use flexibility of the regulatory framework without diluting prudential standards or accounting requirements (for example, extend relief from provisioning on renegotiated loans if recovery stalls).	Weather the short-term impact of COVID-19 while preserving financial system resilience.	Capital buffers were temporarily lowered in an appropriate manner, while the encouraged loan modifications were useful for the recovery consistent with prudential standards. However, the reduced risk-weight on SME credit exposures from 100 percent to 85 percent was not consistent with maintaining prudential standards. 
Continue to pursue financial sector reform	Lower credit spreads, foster financial inclusion.	An instant electronic payment system and first stages of open banking have been launched. 
Structural Policies		
Reduce tariffs and nontariff-barriers, finalize high standard trade agreements with the EU and other trading partners	Open the economy, increase competition and efficiency.	10 percent unilateral import tariff reduction for 1,495 products, including IT and capital goods. All import tariffs previously below 2 percent were cut to zero. 
Conclude negotiations to join the WTO Government Procurement Agreement (GPA)	Open the government procurement market to foreign competition, foster transparency, and good governance.	Negotiations for Brazil's GPA accession are ongoing. 
Close infrastructure gaps.	Alleviate supply bottlenecks, supporting economic growth. Lower transaction costs.	The new sanitation and sewage framework paved the way for important concessions at the subnational level. 34 concession contracts in ports, airports, roads, and railways were celebrated since 2020Q4. The Eletrobras privatization law is expected to bring new investments. 
Finalize and ensure timely dissemination of National Risk Assessment (NRA) results in preparation for the next FATF/GAFILAT.	Strengthen AML and anti-corruption frameworks.	The NRA was finalized in May 2021 and dissemination efforts among relevant stakeholders are on-going. 
Enhance the sharing of beneficial ownership information among relevant competent authorities.	Strengthen AML and anti-corruption frameworks.	No concrete steps have been taken; however, the issue has been included in the 2020 Executive's Anti-Corruption Plan with actions targeted for 2023. 
Continue strengthening the frameworks for asset disclosures, lobbying and whistleblower protection.	Mitigate corruption and money laundering risks, including from procurement fraud (heightened during the pandemic).	No concrete steps have been taken; however the three topics are included in the 2020 Executive's Anti-Corruption Plan. 
External Sector Policy		
Limit the use of foreign exchange intervention to addressing disorderly market conditions.	Use exchange rate as a first buffer against shocks.	Interventions have been limited to episodes of excess volatility. 
1/ See Annex V for an update on implementation of the 2018 FSAP recommendations.		



BRAZIL

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

August 20, 2021

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

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FUND RELATIONS

(As of June 28, 2021)

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)	8124.99	73.58
Reserve Tranche Position	2928.18	26.52
Lending to the Fund		
New Arrangement to Borrow	126.98	

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	2,887.08	100.00
Holdings	2940.91	101.86

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				
	2021	2022	2023	2024	2025
Principal		0.00	0.00	0.00	0.00
Charges/interest		0.05	0.05	0.05	0.05
Total		0.05	0.05	0.05	0.05

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.

The tax on financial transactions (*Imposto sobre Operações Financeiras*, IOF) of 6.38 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 gives rise to a multiple currency practice (MCP) subject to Fund jurisdiction under Article VIII, Sections 2(a) and 3. In January 2008, the IOF for these exchange transactions was raised to 2.38 percent and then further increased to 6.38 percent in March 2011. The scope of operations was expanded to other foreign exchange transactions in addition to credit cards in December 2013.

Last Article IV Consultation

The last Article IV consultation with Brazil was concluded by the Executive Board on November 25, 2020. Brazil is on the 12-month cycle. The Financial Sector Assessment Program (FSAP) took place in 2002 and was updated in 2012 and 2018.

Capacity Development

The Statistics Department (STA) provided technical assistance (remotely) in August 2020 to support the Brazilian Institute of Geography and Statistics (IBGE) in dealing with COVID-19 related challenges in compiling GDP data in the Quarterly National Accounts. The Fiscal Affairs Department (FAD) is supporting the Ministry of Economy in its efforts to strengthen the tax administration system, enhance medium-term fiscal planning, and improve fiscal transparency. Three missions were conducted during 2020: (i) "[Strengthening Fiscal Responsibility at the Subnational Level](#)" in February to provide technical advice on designing subnational fiscal rules. The mission built on the findings of the April 2019 mission on "[Strengthening the Framework for Subnational Borrowing](#)", which provided recommendations to strengthen the institutional framework for subnational public finances with a focus on programs to support states and municipalities under financial distress. (ii) a TADAT Performance Assessment in January; and (iii) supporting the State of São Paulo (remotely) in implementing a cost accounting system for the public sector in April 2020. In recent years, FAD provided technical assistance on Cost Accounting (March 2018), "[Public Investment Management Assessment](#)" (August 2017), "[Supporting Implementation of the Expenditure Rule Through Public Financial Management Reforms](#)" (March 2017), and "[Fiscal Transparency Evaluation](#)" (June 2016).

Resident Representative

The IMF maintains a resident representative office in Brasilia. The Resident Representative is Ms. Joana Pereira, who assumed the post in July 2018.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: <http://www.worldbank.org/en/country/brazil>
- Inter-American Development Bank: <https://www.iadb.org/en/countries/brazil>
- New Development Bank: <https://www.ndb.int/>

STATISTICAL ISSUES

(As of July 12, 2021)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance.
II. Data Standards and Quality
In November 2019, Brazil completed the requirements for adherence to the IMF's SDDS Plus—the highest tier of the Data Standards Initiatives. This made Brazil the first country in Latin America to adhere to the SDDS Plus. As allowed under the SDDS Plus, the requirements on the outstanding three data categories—sectoral balance sheets, other financial corporations survey, and debt securities—will need to be completed within the transition period (i.e., within five years from the adherence date). Implementing G-20 DGI recommendations: The authorities have already implemented a good number of the recommendations and work is underway to implement the remaining ones. Further progress would focus on monetary and financial statistics, real estate price indexes, and sectoral accounts.

Brazil: Table of Common Indicators Required for Surveillance (As of June 28, 2021)					
	Date of Latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	6/28/2021	6/29/2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	May. 2021	6/14/2021	M	M	M
Reserve/Base Money	May. 2021	6/14/2021	D	M	M
Broad Money	May. 2021	6/14/2021	M	M	M
Central Bank Balance Sheet	May. 2021	6/14/2021	M	M	M
Consolidated Balance Sheet of the Banking System	May 2021	6/14/2021	M	M	M
Interest Rates ²	May 2021	6/14/2021	M	M	M
Consumer Price Index	May. 2021	6/1/2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	Apr. 2021	6/1/2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	Apr. 2021	6/1/2021	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Apr. 2021	6/1/2021	M	M	M
External Current Account Balance	May. 2021	6/14/2021	M	M	M
Exports and Imports of Goods and Services	May. 2021	6/14/2021	M	M	M
GDP/GNP	Q1 2021	6/1/2021	Q	Q	Q
Gross External Debt	Q1 2021	6/14/2021	Q	Q	Q
International Investment Position ⁶	Q1 2021	6/1/2021	Q	Q	Q

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

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 Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Mr. Bevilaqua on Brazil
September 10, 2021

On behalf of my Brazilian authorities, I thank staff for the report and dialogue during the Article IV mission. My authorities value the opportunity provided by this policy dialogue.

Absorbing the unprecedented shock and fostering a V-shaped recovery

The authorities' swift, comprehensive, and forceful policy response was key to mitigate the impact of the Covid-19 shock and set the ground for a strong economic recovery. After undertaking crucial measures to adjust and reform the economy, Brazil was set to take off when the Covid-19 crisis struck at the end of the first quarter, last year. Given the magnitude of the shock, the government launched a package of fiscal, monetary, and financial measures that stood out among peers. These measures were debated and approved by congress in record time, in close consultation with the judiciary branch as appropriate. As a result, in 2020, the Brazilian economy shrunk by less than half of what staff estimated mid-year. Also, the strength of the emergency safety net led to a marked reduction in poverty and inequality, the preservation of about 10 million formal jobs, and a strong recovery that has been under way since the second half of last year. Unfortunately, a second wave of Covid-19 in the first quarter of 2021 posed additional challenges to this process.

A new round of policy measures effectively countered the social and economic fallout of the second wave of Covid-19. Among the actions taken, a new, better targeted round of emergency aid was provided, the job retention program was relaunched, measures to secure budgetary resources and a more expeditious process for the acquisition of equipment and inputs in the fight against Covid-19 were adopted, some pension payments were anticipated from the second to the first semester, import tariffs were waived until the end of this year for items essential to fighting Covid-19, and the program to support micro and small businesses was made permanent (5.3 million businesses are eligible under the program).

With the second wave of Covid-19 under control and an effective vaccination rollout, Brazil is well positioned for robust economic growth this year. After overcoming initial supply bottlenecks, which prevailed in many other countries, vaccination in Brazil has picked up steam and, as of end-August, almost 65 percent of the total population was at least partially inoculated, a level higher than in many advanced economies, and almost 30 percent was fully vaccinated. Brazil may soon present one of the highest rates of fully vaccinated population, among the largest countries, given the increased supply of vaccines, capillarity of the health sector network, and very low vaccination hesitancy of the population. Notably, the weekly average number of deaths by Covid has steadily declined by almost 80 percent since its peaks in early April. Of course, the Delta (or other new) variants may pose further challenges, but coverage of immunization in Brazil is becoming an important factor behind the country's strong economic performance.

The drive to implement critical structural reforms has been sustained, even under adverse crisis conditions. The list of successful initiatives with deep and lasting impact in the economy is impressive, and the following measures stand out: central bank independence; a new bankruptcy law; a new sanitation legal framework, which led to the successful privatization of CEDAE, the sanitation company of the State of Rio de Janeiro; the Investment Partnership Program, which has already approved over 60 projects, with expected investments of R\$500 billion over the next few years on top of the boost to public sector

revenues; the approval of the legal framework for the privatization of Eletrobras; anew natural gas law, which will enhance competition, increase investments and reduce prices of this critical energy source and manufacturing input; a new ease of doing business law to streamline and modernize procedures in line with best international practices; trade facilitation measures eliminating procedures and reducing costs that affected over US\$10 billion in imports; a new export processing zone law; the startup and innovation law; and a new procurement law.

Resolute policy support, growth-friendly structural reforms and a strong performance of the commodities' sector bode well for a sharp and sustained economic rebound. While the Brazilian economic performance in 2021 may have surprised many (e.g., the October 2020 WEO projected only 2.8 percent growth for Brazil in 2021), we believe this “surprise” is soundly grounded on the policies and reforms pursued by the authorities, with an additional push from the commodity sector. Staff’s current projection of 5.3 percent GDP growth in 2021—broadly in line with the consensus market forecast—provides a clear indication of Brazil’s successful response to the crisis. Labor market performance, which normally lags output recovery, must always be closely monitored. However, concerns maybe overstated as data for the formal labor market indicate robust net creation of 1.85 million jobs this year through end-July. With the immunization of the population proceeding at a fast pace, job creation should accelerate as labor participation increases in tandem with higher mobility and a pickup in the services sector.

Fiscal policy: forceful and responsible

Fiscal policy has been crucial to protect the most vulnerable and support the economy, while retaining a responsible framework to ensure medium-term fiscal sustainability. Under significant pressure from two waves of Covid-19, the fiscal policy response has been forceful, but without compromising medium-term fiscal sustainability. When the 2021 fiscal support package was approved, the conditions under which the “state of calamity” clause could be activated were further specified and new rules constraining the increase in expenditures were introduced to provide predictability in similar situations in the future. As a result, even with a very large fiscal stimulus in 2020 (especially if compared to peers), responsible management of the fiscal accounts and the stronger than expected performance of the Brazilian economy will lead to a sharp decline in both the fiscal deficit and public debt ratios, each projected to fall by at least 7 percentage points of GDP in 2021. Market participants have also upgraded their fiscal projections for coming years. For 2022, for example, the primary fiscal deficit is now expected to be almost half of the value projected in December 2020.

With the projected plunge in the debt ratio, a robust domestic investors’ base, and the authorities’ steadfast commitment to the expenditure ceiling, risks to debt sustainability are well contained. As noted above, the public debt ratio is projected to fall by more than 7 percentage points in 2021. Under the current framework, fiscal consolidation will continue to ensure a downward path to the public debt. It is interesting to note that every year since the 2018 Article IV consultation staff projected a public debt ratio for 2021 that was well above the one being projected now, even after the crisis. While it is understandable that staff is in the early days of applying the new sovereign risk and debt sustainability framework, it is not clear why the mitigating factors listed by staff would not have moved the needle from the mechanical signal. In the case of gross financing needs, Brazil’s deep domestic investors’ base, sizeable liquidity buffers, and the fact that more than one-quarter of the federal government debt is held by the central bank point to a low rollover risk. Historically, the Treasury has been able to smoothly roll over debt, even under extreme conditions, given these mitigating factors. In

addition, the notion that “fiscal space is at risk” is ill-defined and seems at odds with the comprehensiveness of the current fiscal framework and the proven commitment of the authorities to fiscal prudence.

The expenditure ceiling remains a key anchor. The authorities are fully committed to the expenditure ceiling, which is the cornerstone of the current fiscal framework. During the crisis, as emergency measures were adopted, new triggers were introduced in the Constitution to unleash offsetting measures to contain increases in expenditures, including at the subnational level. While further improvements may always be considered and could be helpful at some point in the future, the current framework is sufficiently strong to ensure that fiscal consolidation will proceed, mitigating remaining fiscal and debt risks. As in any other democracy, the electoral process next year is an integral part of the institutional framework and we anticipate a smooth event. That said, the instruments to cope with possible bouts of volatility are widely available and effectively tested, with proven results.

Removing budgetary rigidities is a priority to help ensure the efficiency of public expenditure and further enhance potential growth. Budget rigidities have constrained discretionary spending, including investment, and contributed to misallocation of resources. However, removing such rigidities in Brazil requires changes to the Constitution, which is always politically challenging. Even so, this administration has pursued reforms that would increase flexibility of the federal and subnational budgets, bolstering social spending and public investments while preserving fiscal and debt sustainability. The pension reform approved in 2019 is an example of such constitutional amendment. The administrative reform sent to congress in 2020—which aims primarily at modernizing and making the public sector more efficient—is another initiative that would enhance budget flexibility. My authorities will continue to work with congress to remove budget rigidities and make the public sector more efficient. That said, we fail to see any meaningful causation from low discretionary spending to protracted budget negotiations as stated in paragraph 18 of the staff report. Budget negotiations are a common feature of democracies in a wide variety of settings, and they oftentimes take longer than expected, as we have seen including in many advanced economies.

Inflationary pressures have been timely addressed

The BCB has started a tightening cycle this year to bring inflation back to the target by end-2022. With activity gathering pace and the combination of higher commodity prices and exchange rate depreciation, price pressures became more widespread and persistent, leading inflation expectations to start moving upwards. More recently, volatile components, such as electricity tariffs and food prices, have been affected by adverse weather conditions, adding further pressure to domestic prices. Since the fourth quarter of last year, the Monetary Policy Committee (Copom) started to adjust its communication in line with this evolving scenario. Later, a tightening cycle was launched, with the policy rate increasing by 325 bps since March, this year. Annual inflation is expected to peak at about 9 percent in the third quarter, converging after that to the target as the tighter monetary stance works through its channels. Given the asymmetry in the balance of risks, the Copom assessed that, assuming no changes in the conditioning factors, a series of interest hikes (up to a level above the neutral rate) is required for inflation to converge to the target by end-2022. It is unfortunate that in the previous Article IV consultation, which was held at the Board in late November, last year, staff recommended the BCB to “continue to cut the policy rate,” despite emerging evidence and our advice to the contrary. This, perhaps, reveals intrinsic limitations of the top-down approach to policy recommendations and, possibly, shortcomings of the Fund’s transparency policy.

The approval of de jure independence of the BCB, and the recent confirmation of its standing by the Supreme Court, will enhance further the BCB's credibility and the transmission of monetary policy. The new central bank law reaffirmed price stability as the core mandate of the institution, which will also tend to financial stability and smoothing the business cycle to help foster economic wellbeing. The BCB will likely benefit from the gains that the international experience associates with greater central bank independence, namely: lower and more stable inflation with less economic cost to monetary policy. The Copom has clearly communicated its focus on the legal mandate of the central bank and will continue to pursue, as described above, a data-dependent strategy to bring inflation back to the target.

The floating exchange rate regime continues to work as an important shock absorber. The BCB remains committed to this regime and does not target any level for the exchange rate. In fact, the real effective exchange rate has depreciated by about 18 percent since the beginning of the crisis, while the central bank intervened only when the market was behaving in a dysfunctional way.

The banking system withstood the health shock well and remains sound. Throughout the crisis there was a sizeable expansion in credit with very low delinquency rates. Meanwhile, the BCB has taken important steps to enhance competition and efficiency in the system. The instant payment scheme (Pix) has been widely accepted and used, reducing costs, fostering competition and efficiency, and promoting financial inclusion. Furthermore, the stepwise implementation of open banking is proceeding steadily with its second phase (which includes sharing data on traditional banking services) having started on August 13. By allowing customers to share their data with other institutions, the new regulation is a critical step to foster competition in the banking system. It shall reduce costs and improve the quality of services provided to the public.

Reforms continue to promote transparency and boost potential growth

Despite the successful implementation to date of an ambitious reform agenda, the authorities remain focused on further measures. Several bills have been already sent to congress, such as the tax reform, the administrative reform, and others related to the ease of doing business agenda. The tax reform approved by the Chamber of Deputies aims at enhancing efficiency, fairness, and compliance. Within the business environment agenda, among the bills already sent to congress are new regulations for the electricity sector, railroads, maritime transportation, private-public partnerships, and concessions. These measures are part of a comprehensive plan to promote regulatory convergence to international standards and practices, reducing costs and red tape. The privatization agenda will continue, opening space for additional private investments in infrastructure.

The authorities remain committed to strengthening the AML/CFT framework in line with FATF standards and recommendations. Brazil has recently finalized its AML/CFT national risk assessment and has implemented more up-to-date banking supervision regulations. Difficulties related to availability and access to beneficial ownership information, which are not specific to Brazil, are being tackled by the authorities under the Federal Government's Anticorruption Plan. By end-2023, a more effective process of validation and consolidation of beneficial ownership information and stricter transparency requirements for companies receiving public funds will be implemented. Moreover, enhanced transparency requirements and monitoring procedures have been adopted in the context of Covid-19

emergency aid. Ultimately, the operating framework for fighting corruption and financial crimes is predictable and stable, based on legal mechanisms, including at the constitutional level, that ensure the independence of all agencies involved.

Closing remarks

Brazil has withstood the Covid-19 shock better than many expected and is well positioned for a robust recovery. Swift, forceful, and effective policy response is at the root of this performance. Despite the challenges posed by the global pandemic, the authorities have remained resolute about their reform agenda to enhance competition, efficiency, and fairness in the economy, boosting its potential growth. Of course, the outlook is not devoid of risks, but continuing to push the needed structural reforms and manage the economy in a responsible manner is the best, if not the only way to promote high, sustainable, and inclusive growth.