Spending Cap – The New Fiscal Regime

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- **We believe the New Fiscal Regime (PEC 241/2016), which we expect to be voted on and approved by year end, would be positive for the current Brazil's fiscal imbalance. By imposing zero growth on primary spending, the proposed new fiscal regime would introduce competition among all federal branches for their share of government expenditures.**
- **Under this proposed regime, which must be voted on as a constitutional amendment, the executive, legislative, and judiciary branches of government, and the whole society, must build an agreement regarding which federal expenditures can grow in real terms, and which federal expenditures will have to be cut in real terms.**
- **We believe that the government proposal will likely undergo changes in Congress; it is therefore important to keep in mind to what extent it could be changed without watering it down significantly. According to our estimates, the New Fiscal Regime will still be effective in addressing the country's fiscal imbalance as long as: (1) the duration of the New Fiscal Regime is of at least five years without changes (the current proposal has it as a minimum 10); and (2) the healthcare, education, and capital spending growth must be curbed toward inflation, if not immediately, then within three years of implementation of the spending cap rule.**
- **Such room for maneuvering exists because, in our view, there is margin for cuts in some non-mandatory spending from the levels seen in the 2016 budget (which will serve as a base and would otherwise be maintained in real terms). These cuts could cushion an eventual real increase in some important sectors such as healthcare, education, and capital spending, in our view.**
- **So far, changes introduced by Congress have been more benign than this. The version approved by the Special Commission postponed by only one year the freeze in real terms of healthcare, education, and capital spending, a modest change compared to the risk pointed out by some, of eventually not applying at all the cap on these expenditures.**
- **In order for the primary spending cap to be effective in the long term, some important mandatory spending will have to decline as a percentage of GDP; therefore, we believe additional measures are required, such as social security reform and the decoupling of social benefits from the minimum wage.**
- **In this report, we also have carried out some exercises to assess the impact of the reform on primary spending and balance, as well as on the public debt/GDP trajectory. We simulate four scenarios, ranging from the best case (reform approved as proposed by the government) to the worst case (possibility of revision as early as 2019, plus not applying the cap on healthcare, education and capital spending). We find that, in the worst case scenario, the reform would be ineffective, and the public debt would continue to rise, exceeding 100% of GDP in 2024. However, should Congress approve the reform as proposed, public debt would be significantly lower than that, at an estimated 60 to 70% of GDP.**

Introduction

In this week the fiscal agenda moved forward in Congress, with the approval of the New Fiscal Regime (also known as "spending growth cap") by the Lower House's Special Commission. The consensus expectation among political and market observers, as well as our expectation[1], is that this reform will be voted on in Congress by the end of December, when Congress goes into recess. This proposal, whose progress we expect will be followed closely by the market, is a constitutional amendment (PEC) limiting the annual rise of expenditures to past inflation – which, in practice, represents a freeze in real terms.

We are confident that the New Fiscal Regime will be approved by Congress, in a relatively speedy vote. In our recent report

[1] For further details, see our report,

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(*Closed for Renovation: The Challenging Reform Agenda,* October 1, 2016) we have stated the reasons why we believe that the bill will be approved by year-end 2016 or 1Q17 at the latest. However, the government's intense efforts in securing a fast track approval – with President Temer personally engaging in negotiations, the economic team meeting with Congressmen to explain the reform and lower resistances, and with the decision of postponing the submission of the social security reform for another month, so not to create distractions – suggests, in our view, that the reform may indeed be approved by the end of this year; and if our expectation proves accurate, the passage of this amendment would be a record achievement for a measure as complex as this is from a legal point of view.

In this report, we attempt to answer the main questions regarding the PEC for spending caps: (1) What is the spending cap rule? (2) Should the Congress decide to introduce changes in the bill, how far could these changes go without eroding the essence of the reform? (3) Considering a few potential scenarios for the final version approved by Congress, how would the reform impact the fiscal accounts and, more importantly, the public debt trajectory?

What is the spending cap rule?

PEC 241/2016 is a constitutional amendment that, if passed, would create a rule that limits primary spending growth to the level of past inflation (see below for more details). According to this rule, in real terms, spending growth would be zero in upcoming years, with the goal of reducing the primary spending ratio to GDP through the next 20 years. Because of this it has been called the "New Fiscal Regime."

Until now there have been no specific limits on federal spending. The Fiscal Responsibility Law has worked as an indirect constraint on spending through the primary fiscal target, with the government setting primary surpluses as a target (without discounts). For almost a decade, there has been no constraint on spending growth, with the primary surplus target being discounted by public investments, and recently with the government revising the primary surpluses target to deficits. Since 1997, federal spending (discounting the economic cycle) increased by approximately 1.5% of GDP per year (for further details, see our report, *The Fiscal Maze I: Origins, August 6, 2015*). Between 1997 and today, federal spending increased faster than real GDP growth (2.6% p.a. on average), climbing from BRL 132.9 billion (14.0% of GDP) to BRL 1.2 trillion (19.6% of GDP). In the first years of this period, an increasing tax burden and economic growth in the early 2000s resulted in primary surpluses that overshadowed the upward trend of the ratio of spending to GDP.

This New Fiscal Regime proposed in PEC 241/2016 introduces competition among all federal branches for their share of government expenditures. If the amendment is passed, the executive, legislative, and judiciary branches, and the whole society, will have to build an agreement regarding which federal expenditures can grow in real terms, and which federal expenditures must be cut in real terms.

The PEC 241/2016 aims to introduce the new fiscal regime for 20 years and to limit the growth of federal primary spending to the level of consumer price inflation of the previous year for at least the next 10 years, beginning in 2017. According to the PEC, the spending growth rule can be amended only by a proposal from the president of the republic, and only after the 10th year of the measure's implementation.

In summary, the government's initial proposal (PEC 241/2016) had the following main points:

A) The correction method is based on federal primary spending in 2016 plus consumer price inflation (IPCA), which means that 2017 primary spending will be the primary spending in 2016 plus IPCA for 2016, and 2018 primary spending will be 2017 primary spending plus IPCA for 2017, and so on.

B) Primary spending is total federal spending excluding constitutional transfers, mandatory transfers due to earmarked revenue, nonrecurring spending (for unforeseeable and urgent situations such as weather or ecological disasters), electoral spending, and state-owned companies' capitalization. The spending that is excluded has hovered at under 2% of GDP.

C) The correction method will be applied for each branch of the federal government (legislative, executive, and judiciary) discretely, which means that each branch of the government will have to limit its spending growth to the inflation of the previous year.

D) The length of the new rule is 20 years, and it can be changed only after the 10th year of implementation by a proposal from the president of the republic.

E) If the a branch of government does not adhere to the limits on spending growth, the penalties are: for the branch of government, there is a ban on increasing the payroll of civil servants and on increasing social charges, and the executive branch in particular is not allowed to increase subsidies and tax benefits through tax exemptions.

The Special Commission proposed some changes to PEC 241/2016. The current version has the following changes:

1) The correction method for healthcare and education spending is be based on spending levels in 2017, while other federal primary spending remains based on spending in 2016, which means that the spending cap rule will be applied on healthcare and education spending from 2018 onwards
2) The correction method for the parliamentary amendments, which are accounted for as capital spending, is to be based on spending levels in 2017. This means that the spending cap rule will be applied on parliamentary spending from 2018 onwards, as well.
3) After the 10th year of the New Fiscal Regime's implementation, the spending growth rule can be revised and changed every new mandate by a president of the republic proposal
4) In the first three years, the executive may voluntarily and temporarily transfer 0.25% of its spending limit to the legislative and/or judiciary if it does not reach the limit of spending growth.
5) From 2018 onward, the correction method will be year-over-year inflation measured at mid-year. For 2017 only, spending growth will be limited by the expectation of the previous year's inflation.

It is important to note that the Special Commission is maintaining the 20-year period proposed by the government, which is positive news, in our view, and increases the likelihood that Congress will approve the period originally proposed. Moreover, the change proposed by the Special Commission for Healthcare, Education, and Investment Spending (moving the spending baseline year from 2016 to 2017 year-base) is modest compared with the possibility of not applying the cap on these expenditures.

How far could Congress changes go without eroding the essence of the reform?

One of the most significant criticisms regarding the PEC for spending cap (New Fiscal Regime) is the duration of the new rule (20 years). In the view of the report published in August 2016by the Budget Advisory and Financial Supervision (CONOF) of the Lower House, the duration of the new fiscal regime seems excessive, especially if the country returns to growth of around 3% p.a. in real terms on average, because in this case the new fiscal regime will produce primary surpluses higher than necessary to stabilize the debt ratio to GDP. We ran two exercises on the central government's fiscal balance in the 2016-2021 period, one using the government's budget proposals for 2016 and 2017, and the other using our assumptions. According to these exercises, we forecast a downward trend in the expenditures ratio to GDP from 2019-2020 onward. That said, in order for that to occur, **the New Fiscal Regime's duration has to be at least five years without changes.**

Another important criticism regarding the PEC for spending cap is that it would limit healthcare and education spending to zero real growth. According to the government proposal, the basis for calculating the spending limit on primary spending is the amount of effective spending in the 2016 fiscal year, which had the highest fiscal budget deficit since the beginning of the "Real Plan" in 1994. That said, **we believe there are margin in some non-mandatory spending that could be cut in order to maintain federal expenditures in some important sectors such as healthcare, education, and capital spending growing above the consumer inflation in the first years of the New Fiscal Regime's implementation.** For instance, we highlight (I) the economic subsidies that are inflated by the 2014-15 fiscal maneuvers payments, and (II) other current expenditures, which are hovering at BRL 44 billion but previously ran below BRL 30 billion p.a. until 2014. We believe these federal expenditures might easily be reduced in the upcoming years. The 2014-15 fiscal maneuver payment is expected to end this year, which means that economic subsidies should post a significant reduction next year, in our view; from 2018 onward, we expect economic subsidies to continue to decrease due to the end of PSI loans subsidies. The other current expenditures item is non-mandatory spending that the government can cut to help stay under the spending cap and, at the same time, demonstrate its commitment to fiscal austerity.

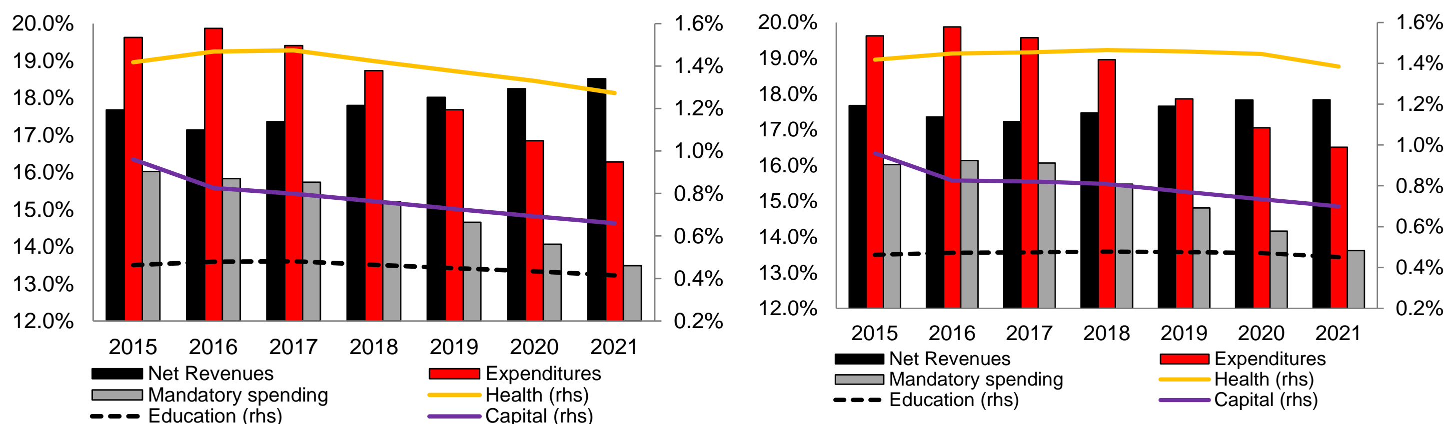
In our opinion, the reduction of economic subsidies and other current expenditures in the next two years should be sufficient to maintain healthcare and education spending growth above consumer inflation without exceeding the cap or imposing a significant reduction in capital spending. Therefore, we see the change of the year-base proposed by the Special Commission's rapporteur as a good solution to the problem of avoiding excessive cuts in healthcare and education. In contrast, the primary spending ratio to GDP may register a steep drop, in our view, because the inflation expectation and the nominal GDP growth figures for 2017 are close, and the disinflation between 2016 and 2017 and the real GDP growth we expect are likewise similar. **In a scenario of inflation stability and economic growth, the principle of the spending cap works to put the expenditures ratio to GDP in a downward trend.** None of these exercises has indicated that a significant reduction in capital spending will be needed to meet the spending cap. However, it is important to highlight that the spending cap will represent an important fiscal constraint from 2019 onward when spending growth has to be curbed to 4.5% (consensus' inflation expectation from 2018 onward).

In order to stay within the limits for spending growth imposed by the cap, the ratio to GDP of every federal expenditure

will have to decline, according to our estimates. If the spending cap rule is applied, the ratio of non-mandatory spending to GDP will decline. However, in order to stay at the primary spending cap, some important mandatory spending will also have to decline as a ratio to GDP. Thus, additional measures will be required, in our view, such as social security reform and the decoupling of social spending (social security benefits + unemployment insurance + non-contributory social assistance) from the minimum wage adjustment policy (real GDP growth two years ago + consumer inflation one year ago).

Federal revenue and expenditures (% of GDP) – based on budget proposals for 2016 and 2017

Federal revenue and expenditures (% of GDP) – based on Santander's assumptions



Sources both charts: SIAFI, Finance Ministry, and Santander estimates.

How would the reform impact the fiscal accounts?

As we mentioned above, according to our exercises the minimum duration for the New Fiscal Regime is five years, which implies that spending growth is restricted to zero growth in real terms for the next government (2019-2021). **If political negotiations allow the next government to revise the spending growth rule, we project that the federal expenditures ratio to GDP will continue on an upward trend, which reduces the likelihood of stabilizing net and gross debt in the medium term** (from 2020 onward, according to our forecast).

If the Congress excludes healthcare and education spending from the spending cap, and moreover, maintains the current percent of GDP targets for those areas, we project that the federal expenditures ratio to GDP will continue on an upward trend, which, again, reduces the likelihood of stabilizing net and gross debt in the medium term (from 2020 onward, according to our forecast).

In the following table, we present four exercises to assess the potential impact of various government policies on the central government's primary balance, net debt, and gross debt in the 2016-2024 period. Exercise (A) considers the government budget proposals for 2016 and 2017; (B) considers our assumptions; (C) assumes the spending cap rule is not applied to health and education spending, and that the government offsets the negative impact on primary results by cutting capital spending; and (D) considers the spending cap rule being revised by the next government (2019-2021 period), and assumes that health, education spending, and capital spending are excluded from the spending cap rule from 2019 onward.

The most unfavorable primary balance, net, and gross debt trends are seen in scenario D, where the spending cap rule is loosened before five years. Under this scenario, we believe Brazil would face another round of swings in risk premium, exchange rate, and interest rate. In Scenario C, the central government fulfills the primary spending cap requirement by reducing capital spending to 0.1% of GDP by the end of 2024. However, scenario C is not positive, despite the downward trend of public debt, because in our opinion, it is not feasible to keep reducing capital spending for such a long period. Scenarios A and B result in downward trends for net and gross debt, mainly because we expect the fiscal effort to promote an improvement in confidence and investments, while helping to curb inflation and ease monetary policy due to a tightening in fiscal policy. The difference between scenarios A and B is that inflation is higher in scenario B, which allows a smoother fiscal adjustment than in scenario A.

Primary balance and public debt simulation

		2016	2017	2018	2019	2020	2021	2022	2023	2024
	Primary balance	-2.73%	-2.05%	-0.94%	0.33%	1.40%	2.24%	3.18%	4.25%	5.17%
A	Net debt ratio to GDP	44.9%	48.4%	50.1%	50.8%	50.5%	48.9%	46.4%	42.7%	38.0%
	Gross debt ratio to GDP	74.0%	78.8%	80.5%	81.3%	80.9%	79.4%	76.8%	73.1%	68.4%
	Primary balance	-2.52%	-2.35%	-1.49%	-0.21%	0.78%	1.33%	1.66%	2.11%	2.40%
B	Net debt ratio to GDP	44.9%	48.5%	50.7%	52.0%	52.3%	51.6%	50.5%	48.8%	46.6%
	Gross debt ratio to GDP	73.8%	78.9%	81.1%	82.4%	82.8%	82.1%	80.9%	79.2%	77.1%
	Primary balance	-2.52%	-2.25%	-1.31%	-0.01%	1.00%	1.57%	1.83%	2.18%	2.37%
C	Net debt ratio to GDP	44.9%	48.4%	51.2%	52.6%	53.1%	53.0%	52.5%	51.7%	50.7%
	Gross debt ratio to GDP	73.8%	78.8%	81.6%	83.1%	83.6%	83.4%	83.0%	82.2%	81.1%
	Primary balance	-2.52%	-2.36%	-1.41%	-0.27%	0.53%	0.78%	0.83%	1.00%	1.00%
D	Net debt ratio to GDP	44.9%	50.7%	54.1%	57.4%	59.9%	62.2%	64.6%	66.8%	69.1%
	Gross debt ratio to GDP	74.3%	81.1%	84.5%	87.8%	90.3%	92.6%	95.0%	97.2%	99.5%

(A) considers the government budget proposals for 2016 and 2017; (B) considers our assumptions; (C) assumes the spending cap rule is r applied to health and education spending, and that the government offsets the negative impact on primary results by cutting capital spending; a (D) considers the spending cap rule being revised by the next government (2019-2021 period), and assumes that health, education spending, a capital spending are excluded from the spending cap rule from 2019 onward

Sources: Finance Ministry and Santander estimates.

Appendix: The Central Government borrowing requirement simulations

A- Central Government budget proposals for 2016 and 2017

	Realized 2015	Budget 2016		Budget 2017		Budget 2018		Budget 2019		Budget 2020		Budget 2021		Budget 2022		Budget 2023		Budget 2024	
Total Revenues	1,248.7	1,276.1	2.2%	1,409.6	10.5%	1,581.0	12.2%	1,754.3	11.0%	1,948.1	11.0%	2,155.7	10.7%	2,386.9	10.7%	2,644.3	10.8%	2,931.1	10.8%
Tax collection	798.8	776.5	-2.8%	868.4	11.8%	984.2	13.3%	1,115.4	13.3%	1,264.2	13.3%	1,423.6	12.6%	1,603.2	12.6%	1,805.4	12.6%	2,033.1	12.6%
Social security revenues	350.3	358.6	2.4%	381.1	6.3%	408.0	7.1%	436.9	7.1%	467.8	7.1%	500.8	7.1%	536.2	7.1%	574.2	7.1%	614.7	7.1%
Concession/Dividends/Others	141.4	140.9	-0.3%	160.2	13.7%	188.8	17.8%	202.0	7.0%	216.1	7.0%	231.3	7.0%	247.4	7.0%	264.8	7.0%	283.3	7.0%
Transfer to Reginal Governments	204.9	206.1	0.6%	232.3	12.7%	257.1	10.7%	284.5	10.7%	314.9	10.7%	346.7	10.1%	381.7	10.1%	420.2	10.1%	462.6	10.1%
Net Revenues	**1,043.7**	**1,070.0**	**2.5%**	**1,177.3**	**10.0%**	**1,323.9**	**12.5%**	**1,469.8**	**11.0%**	**1,633.2**	**11.1%**	**1,809.1**	**10.8%**	**2,005.2**	**10.8%**	**2,224.1**	**10.9%**	**2,468.6**	**11.0%**
Total Expenditures	**1,158.7**	**1,240.5**	**7.1%**	**1,316.3**	**6.1%**	**1,393.6**	**5.9%**	**1,442.8**	**3.5%**	**1,508.2**	**4.5%**	**1,590.4**	**5.4%**	**1,665.8**	**4.7%**	**1,729.4**	**3.8%**	**1,811.6**	**4.8%**
Primary Expenditures	**1,158.1**	**1,240.4**	**7.1%**	**1,316.3**	**6.1%**	**1,378.9**	**4.8%**	**1,442.8**	**4.6%**	**1,508.2**	**4.5%**	**1,576.5**	**4.5%**	**1,651.1**	**4.7%**	**1,729.4**	**4.7%**	**1,811.6**	**4.8%**
Mandatory Spendings	**945.9**	**988.2**	**4.5%**	**1,067.0**	**8.0%**	**1,131.3**	**6.0%**	**1,195.6**	**5.7%**	**1,259.1**	**5.3%**	**1,317.8**	**4.7%**	**1,382.4**	**4.9%**	**1,450.3**	**4.9%**	**1,521.5**	**4.9%**
Payroll	237.6	259.9	9.4%	283.6	9.1%	297.7	5.0%	311.1	4.5%	325.1	4.5%	339.8	4.5%	355.1	4.5%	371.0	4.5%	387.7	4.5%
Social Security benefits	**436.3**	**507.8**	**16.4%**	**562.4**	**10.7%**	**627.0**	**11.5%**	**678.5**	**8.2%**	**722.6**	**6.5%**	**762.3**	**5.5%**	**804.2**	**5.5%**	**848.5**	**5.5%**	**895.1**	**5.5%**
Other Mandatory Spendings	**272.1**	**220.5**	**-19.0%**	**221.1**	**0.3%**	**206.5**	**-6.6%**	**206.0**	**-0.3%**	**211.4**	**2.6%**	**215.7**	**2.0%**	**223.1**	**3.4%**	**230.8**	**3.4%**	**238.7**	**3.4%**
Workers support fund (FAT)	47.3	51.1	8.0%	54.9	7.5%	57.9	5.5%	61.1	5.5%	63.9	4.5%	66.1	3.5%	68.4	3.5%	70.8	3.5%	73.3	3.5%
Assistance Benefits (LOAS e RMV)	43.4	47.7	10.0%	51.3	7.5%	54.1	5.5%	57.1	5.5%	59.6	4.5%	61.7	3.5%	63.9	3.5%	66.1	3.5%	68.4	3.5%
Economic subsidies	112.2	55.2	-50.8%	44.7	-18.9%	20.7	-53.6%	10.7	-48.2%	7.7	-27.9%	4.9	-36.2%	4.9	0.0%	4.9	0.0%	4.9	0.0%
Bolsa Família	26.4	28.1	6.3%	29.8	6.3%	31.6	5.8%	33.0	4.5%	34.1	3.5%	35.3	3.5%	36.6	3.5%	37.8	3.5%	39.2	3.5%
Others	42.8	38.5	-10.0%	40.3	4.8%	42.2	4.5%	44.1	4.5%	46.0	4.5%	47.6	3.5%	49.3	3.5%	51.0	3.5%	52.8	3.5%
Non-Mandatory Spendings	**212.2**	**252.2**	**18.9%**	**249.3**	**-1.2%**	**247.6**	**-0.7%**	**247.3**	**-0.1%**	**249.1**	**0.7%**	**258.7**	**3.8%**	**268.7**	**3.9%**	**279.1**	**3.9%**	**290.0**	**3.9%**
Capital expenditures	**56.7**	**51.6**	**-9.0%**	**54.2**	**8.0%**	**56.8**	**4.8%**	**59.3**	**4.5%**	**62.0**	**4.5%**	**64.5**	**4.0%**	**67.1**	**4.0%**	**69.7**	**4.0%**	**72.5**	**4.0%**
Other curent expenditures	155.5	200.6	29.0%	195.1	-2.7%	190.9	-2.2%	188.0	-1.5%	187.1	-0.4%	194.2	3.8%	201.6	3.8%	209.4	3.8%	217.5	3.9%
Health	**83.7**	**91.7**	**9.5%**	**99.9**	**9.0%**	**105.9**	**6.0%**	**112.3**	**6.0%**	**119.0**	**6.0%**	**124.4**	**4.5%**	**130.0**	**4.5%**	**135.8**	**4.5%**	**141.9**	**4.5%**
Education	**27.3**	**29.9**	**9.5%**	**32.6**	**9.0%**	**34.5**	**6.0%**	**36.6**	**6.0%**	**38.8**	**6.0%**	**40.6**	**4.5%**	**42.4**	**4.5%**	**44.3**	**4.5%**	**46.3**	**4.5%**
Other expenditures	44.4	59.1	33.1%	48.8	-17.4%	48.8	0.0%	39.1	-20.0%	29.3	-25.0%	29.3	0.0%	29.3	0.0%	29.3	0.0%	29.3	0.0%
Aid for Regional government + Committed investments expenses net from Foreign asset repatriation	-	19.9		13.8	-99.9%	1.6	-88.6%												
Fiscal Balance of central gov't (primary balance)	**115.0**	**170.5**		**139.0**		**69.7**		**(26.9)**		**(124.9)**		**(218.7)**		**(339.4)**		**(494.7)**		**(657.0)**	
Fiscal Balanceof central gov't (primary balance) % GDP	**1.9%**	**2.7%**		**2.1%**		**0.9%**		**-0.3%**		**-1.4%**		**-2.2%**		**-3.2%**		**-4.2%**		**-5.2%**	
Net revenues ratio to GDP	**17.7%**	**17.1%**		**17.4%**		**17.8%**		**18.0%**		**18.2%**		**18.5%**		**18.8%**		**19.1%**		**19.4%**	
Total Expenditures ratio to GDP	**19.6%**	**19.9%**		**19.4%**		**18.7%**		**17.7%**		**16.9%**		**16.3%**		**15.6%**		**14.9%**		**14.3%**	

Sources: Finance Ministry and Santander estimates.

B- Santander assumptions (2016-2024)

	Realized 2015	2016		2017		2018		2019		2020		2021		2022		2023		2024	
Total Revenues	1,248.7	1,296.5	3.8%	1,396.5	7.7%	1,542.9	10.5%	1,702.7	10.4%	1,882.1	10.5%	2,055.5	9.2%	2,197.0	6.9%	2,348.4	6.9%	2,510.6	6.9%
Tax collection	798.8	797.0	-0.2%	860.0	7.9%	931.2	7.6%	1,032.4	8.1%	1,147.4	11.1%	1,279.3	11.5%	1,376.9	7.6%	1,482.0	7.6%	1,595.0	7.6%
Social security revenues	350.3	358.6	2.4%	377.2	5.2%	408.0	5.0%	452.3	5.0%	501.5	5.0%	526.6	5.0%	553.0	5.0%	580.7	5.0%	609.8	5.0%
Concession/Dividends/Others	141.4	140.9	-0.3%	159.3	13.1%	203.7	27.9%	218.0	7.0%	233.3	7.0%	249.6	7.0%	267.1	7.0%	285.8	7.0%	305.8	7.0%
Transfer to Reginal Governments	204.9	212.7	3.8%	228.3	7.3%	243.4	6.6%	262.0	7.6%	286.2	9.2%	312.5	9.2%	331.5	6.1%	351.8	6.1%	373.2	6.1%
Net Revenues	**1,043.7**	**1,083.8**	**3.8%**	**1,168.3**	**7.8%**	**1,299.5**	**11.2%**	**1,440.7**	**10.9%**	**1,596.0**	**10.8%**	**1,743.1**	**9.2%**	**1,865.4**	**7.0%**	**1,996.7**	**7.0%**	**2,137.4**	**7.0%**
Total Expenditures	**1,158.7**	**1,241.3**	**7.1%**	**1,327.7**	**7.0%**	**1,410.3**	**6.2%**	**1,457.7**	**3.4%**	**1,526.4**	**4.7%**	**1,613.2**	**5.7%**	**1,690.2**	**4.8%**	**1,755.2**	**3.9%**	**1,839.0**	**4.8%**
Primary Expenditures	**1,158.1**	**1,241.2**	**7.2%**	**1,327.7**	**7.0%**	**1,395.5**	**5.1%**	**1,457.7**	**4.5%**	**1,526.4**	**4.7%**	**1,599.4**	**4.8%**	**1,675.4**	**4.8%**	**1,755.2**	**4.8%**	**1,839.0**	**4.8%**
Mandatory Spendings	**945.9**	**1,007.6**	**6.5%**	**1,089.5**	**8.1%**	**1,151.3**	**5.7%**	**1,208.5**	**5.0%**	**1,267.7**	**4.9%**	**1,330.4**	**4.9%**	**1,395.6**	**4.9%**	**1,464.1**	**4.9%**	**1,536.1**	**4.9%**
Payroll	237.6	270.4	13.8%	294.0	8.7%	313.2	6.5%	328.9	5.0%	343.7	4.5%	359.1	4.5%	375.3	4.5%	392.2	4.5%	409.8	4.5%
Social Security benefits	**436.3**	**507.8**	**16.4%**	**574.0**	**13.0%**	**630.0**	**9.8%**	**674.8**	**7.1%**	**719.0**	**6.6%**	**762.2**	**6.0%**	**804.1**	**5.5%**	**848.3**	**5.5%**	**895.0**	**5.5%**
Other Mandatory Spendings	**272.1**	**229.3**	**-15.7%**	**221.6**	**-3.4%**	**208.1**	**-6.1%**	**204.8**	**-1.6%**	**205.0**	**0.1%**	**209.1**	**2.0%**	**216.2**	**3.4%**	**223.7**	**3.4%**	**231.3**	**3.4%**
Workers support fund (FAT)	47.3	50.6	7.0%	60.1	18.7%	64.0	6.5%	67.8	6.0%	70.9	4.4%	73.3	3.5%	75.9	3.5%	78.6	3.5%	81.3	3.5%
Assistance Benefits (LOAS e RMV)	43.4	47.7	10.0%	52.6	10.4%	56.1	6.5%	59.5	6.0%	62.1	4.4%	64.3	3.5%	66.5	3.5%	68.8	3.5%	71.3	3.5%
Economic subsidies	112.2	68.7	-38.8%	43.2	-37.2%	19.2	-55.6%	9.2	-52.2%	6.2	-32.7%	4.4	-29.2%	4.4	0.0%	4.4	0.0%	4.4	0.0%
Bolsa Família	26.4	28.1	6.3%	29.8	6.3%	31.3	4.8%	32.7	4.5%	33.8	3.5%	35.0	3.5%	36.2	3.5%	37.5	3.5%	38.8	3.5%
Others	42.8	34.2	-20.0%	35.9	4.8%	37.6	4.8%	35.7	-5.0%	32.1	-10.0%	32.1	0.0%	33.3	3.5%	34.4	3.5%	35.6	3.5%
Non-Mandatory Spendings	**212.2**	**233.6**	**10.1%**	**238.2**	**2.0%**	**244.2**	**2.5%**	**249.2**	**2.0%**	**258.7**	**3.8%**	**269.0**	**4.0%**	**279.8**	**4.0%**	**291.1**	**4.0%**	**302.9**	**4.0%**
Capital expenditures	**56.7**	**51.6**	**-9.0%**	**55.7**	**8.0%**	**60.2**	**8.0%**	**62.9**	**4.5%**	**65.7**	**4.5%**	**68.3**	**4.0%**	**71.1**	**4.0%**	**73.9**	**4.0%**	**76.9**	**4.0%**
Other curent expenditures	155.5	182.0	17.1%	182.5	0.2%	184.0	0.9%	186.3	1.2%	193.0	3.6%	200.7	4.0%	208.7	4.0%	217.2	4.0%	226.0	4.1%
Health	**83.7**	**90.4**	**8.0%**	**98.6**	**9.0%**	**109.0**	**10.5%**	**119.0**	**4.5%**	**129.4**	**4.5%**	**135.2**	**4.5%**	**141.3**	**4.5%**	**147.6**	**4.5%**	**154.3**	**4.5%**
Education	**27.3**	**29.5**	**8.0%**	**32.1**	**9.0%**	**35.5**	**10.5%**	**38.8**	**4.5%**	**42.2**	**4.5%**	**44.1**	**4.5%**	**46.1**	**4.5%**	**48.2**	**4.5%**	**50.3**	**4.5%**
Other expenditures	44.4	42.2	-5.0%	38.0	-10.0%	38.0	0.0%	28.5	-25.0%	21.4	-25.0%	21.4	0.0%	21.4	0.0%	21.4	0.0%	21.4	0.0%
Aid for Regional government + Committed investments expenses net from Foreign asset repatriation revenue	-	19.9		13.8	-30.9%	1.6	-88.6%												
Fiscal Balance of central gov't (primary balance)	**115.0**	**157.5**		**159.4**		**110.7**		**16.9**		**(69.6)**		**(129.8)**		**(175.3)**		**(241.4)**		**(298.4)**	
Fiscal Balanceof central gov't (primary balance) % GDP	**1.9%**	**2.5%**		**2.4%**		**1.5%**		**0.2%**		**-0.8%**		**-1.3%**		**-1.7%**		**-2.1%**		**-2.4%**	
Net revenues ratio to GDP	**17.7%**	**17.4%**		**17.2%**		**17.5%**		**17.7%**		**17.8%**		**17.8%**		**17.6%**		**17.4%**		**17.2%**	
Total Expenditures ratio to GDP	**19.6%**	**19.9%**		**19.6%**		**19.0%**		**17.9%**		**17.1%**		**16.5%**		**16.0%**		**15.3%**		**14.8%**	

Sources: Finance Ministry and Santander estimates.

C- Spending cap rule is not applied to health and education spending

	Realized																		
	2015	2016		2017		2018		2019		2020		2021		2022		2023		2024	
Total Revenues	1,248.7	1,296.5	3.8%	1,396.5	7.7%	1,542.9	10.5%	1,702.7	10.4%	1,882.1	10.5%	2,059.8	9.4%	2,197.3	6.7%	2,344.1	6.7%	2,500.8	6.7%
Tax collection	798.8	797.0	-0.2%	860.0	7.9%	931.2	8.9%	1,032.4	8.9%	1,147.4	11.1%	1,279.3	11.5%	1,368.3	7.0%	1,463.5	7.0%	1,565.3	7.0%
Social security revenues	350.3	358.6	2.4%	377.2	5.2%	408.0	5.9%	452.3	5.9%	501.5	5.9%	530.8	5.9%	561.9	5.9%	594.9	5.9%	629.7	5.9%
Concession/Dividends/Others	141.4	140.9	-0.3%	159.3	13.1%	203.7	27.9%	218.0	7.0%	233.3	7.0%	249.6	7.0%	267.1	7.0%	285.8	7.0%	305.8	7.0%
Transfer to Reginal Governments	204.9	212.7	3.8%	228.3	7.3%	243.4	6.6%	262.0	7.6%	286.2	9.2%	312.5	9.2%	329.9	5.6%	348.2	5.6%	367.6	5.6%
Net Revenues	**1,043.7**	**1,083.8**	**3.8%**	**1,168.3**	**7.8%**	**1,299.5**	**11.2%**	**1,440.7**	**10.9%**	**1,596.0**	**10.8%**	**1,747.3**	**9.5%**	**1,867.5**	**6.9%**	**1,995.9**	**6.9%**	**2,133.2**	**6.9%**
Total Expenditures	**1,158.7**	**1,241.3**	**7.1%**	**1,321.2**	**6.4%**	**1,396.7**	**5.7%**	**1,441.2**	**3.2%**	**1,506.6**	**4.5%**	**1,593.6**	**5.8%**	**1,673.6**	**5.0%**	**1,744.4**	**4.2%**	**1,836.6**	**5.3%**
Primary Expenditures	**1,158.1**	**1,241.2**	**7.2%**	**1,321.2**	**6.4%**	**1,382.0**	**4.6%**	**1,441.2**	**4.3%**	**1,506.6**	**4.5%**	**1,579.8**	**4.9%**	**1,658.9**	**5.0%**	**1,744.4**	**5.2%**	**1,836.6**	**5.3%**
Mandatory Spendings	**945.9**	**1,007.6**	**6.5%**	**1,089.5**	**8.1%**	**1,151.3**	**5.7%**	**1,208.5**	**5.0%**	**1,267.7**	**4.9%**	**1,330.4**	**4.9%**	**1,395.6**	**4.9%**	**1,464.1**	**4.9%**	**1,536.1**	**4.9%**
Payroll	237.6	270.4	13.8%	294.0	8.7%	313.2	6.5%	328.9	5.0%	343.7	4.5%	359.1	4.5%	375.3	4.5%	392.2	4.5%	409.8	4.5%
Social Security benefits	**436.3**	**507.8**	**16.4%**	**574.0**	**13.0%**	**630.0**	**9.8%**	**674.8**	**7.1%**	**719.0**	**6.6%**	**762.2**	**6.0%**	**804.1**	**5.5%**	**848.3**	**5.5%**	**895.0**	**5.5%**
Other Mandatory Spendings	**272.1**	**229.3**	**-15.7%**	**221.6**	**-3.4%**	**208.1**	**-6.1%**	**204.8**	**-1.6%**	**205.0**	**0.1%**	**209.1**	**2.0%**	**216.2**	**3.4%**	**223.7**	**3.4%**	**231.3**	**3.4%**
Workers support fund (FAT)	47.3	50.6	7.0%	60.1	18.7%	64.0	6.5%	67.8	6.0%	70.9	4.4%	73.3	3.5%	75.9	3.5%	78.6	3.5%	81.3	3.5%
Assistance Benefits (LOAS e RMV)	43.4	47.7	10.0%	52.6	10.4%	56.1	6.5%	59.5	6.0%	62.1	4.4%	64.3	3.5%	66.5	3.5%	68.8	3.5%	71.3	3.5%
Economic subsidies	112.2	68.7	-38.8%	43.2	-37.2%	19.2	-55.6%	9.2	-52.2%	6.2	-32.7%	4.4	-29.2%	4.4	0.0%	4.4	0.0%	4.4	0.0%
Bolsa Família	26.4	28.1	6.3%	29.8	6.3%	31.3	4.8%	32.7	4.5%	33.8	3.5%	35.0	3.5%	36.2	3.5%	37.5	3.5%	38.8	3.5%
Others	42.8	34.2	-20.0%	35.9	4.8%	37.6	4.8%	35.7	-5.0%	32.1	-10.0%	32.1	0.0%	33.3	3.5%	34.4	3.5%	35.6	3.5%
Non-Mandatory Spendings	**212.2**	**233.6**	**10.1%**	**231.6**	**-0.8%**	**230.6**	**-0.4%**	**232.8**	**0.9%**	**238.9**	**2.6%**	**249.4**	**4.4%**	**263.3**	**5.6%**	**280.3**	**6.5%**	**300.4**	**7.2%**
Capital expenditures	**56.7**	**51.6**	**-9.0%**	**47.0**	**-9.0%**	**42.3**	**-10.0%**	**40.1**	**-5.0%**	**37.3**	**-7.0%**	**29.9**	**-20.0%**	**23.9**	**-20.0%**	**19.1**	**-20.0%**	**15.3**	**-20.0%**
Other curent expenditures	155.5	182.0	17.1%	184.7	1.5%	188.4	2.0%	192.6	2.3%	201.5	4.6%	219.5	8.9%	239.4	9.0%	261.2	9.1%	285.1	9.2%
Health	**83.7**	**90.4**	**8.0%**	**100.2**	**10.9%**	**112.2**	**11.9%**	**123.8**	**10.3%**	**135.9**	**9.8%**	**149.4**	**10.0%**	**164.4**	**10.0%**	**180.8**	**10.0%**	**198.9**	**10.0%**
Education	**27.3**	**29.5**	**8.0%**	**32.7**	**10.9%**	**36.6**	**11.9%**	**40.4**	**10.3%**	**44.3**	**9.8%**	**48.7**	**10.0%**	**53.6**	**10.0%**	**59.0**	**10.0%**	**64.9**	**10.0%**
Other expenditures	44.4	42.2	-5.0%	38.0	-10.0%	38.0	0.0%	28.5	-25.0%	21.4	-25.0%	21.4	0.0%	21.4	0.0%	21.4	0.0%	21.4	0.0%
Aid for Regional government + Committed investments expenses net from Foreign asset repatriation revenue	-	19.9		13.8	-30.9%	1.6	-88.6%												
Fiscal Balance of central gov't (primary balance)	**115.0**	**157.5**		**152.9**		**97.1**		**0.5**		**(89.4)**		**(153.7)**		**(193.9)**		**(251.5)**		**(296.6)**	
Fiscal Balanceof central gov't (primary balance) % GDP	**1.9%**	**2.5%**		**2.3%**		**1.3%**		**0.0%**		**-1.0%**		**-1.6%**		**-1.8%**		**-2.2%**		**-2.4%**	
Net revenues ratio to GDP	**17.7%**	**17.4%**		**17.2%**		**17.5%**		**17.7%**		**17.8%**		**17.9%**		**17.6%**		**17.3%**		**17.0%**	
Total Expenditures ratio to GDP	**19.6%**	**19.9%**		**19.5%**		**18.8%**		**17.7%**		**16.8%**		**16.3%**		**15.8%**		**15.1%**		**14.7%**	

Sources: Finance Ministry and Santander estimates.

D- Spending cap rule being revised by the next government (2019-2021 period)

	Realized																		
	2015	2016		2017		2018		2019		2020		2021		2022		2023		2024	
Total Revenues	1,248.7	1,296.5	3.8%	1,396.5	7.7%	1,542.9	10.5%	1,702.7	10.4%	1,882.1	10.5%	2,056.5	9.3%	2,196.8	6.8%	2,346.7	6.8%	2,507.1	6.8%
Tax collection	798.8	797.0	-0.2%	860.0	7.9%	931.2	7.9%	1,032.4	7.9%	1,147.4	11.1%	1,279.3	11.5%	1,374.6	7.4%	1,476.9	7.4%	1,586.9	7.4%
Social security revenues	350.3	358.6	2.4%	377.2	5.2%	408.0	5.2%	452.3	5.2%	501.5	5.2%	527.6	5.2%	555.1	5.2%	584.0	5.2%	614.5	5.2%
Concession/Dividends/Others	141.4	140.9	-0.3%	159.3	13.1%	203.7	27.9%	218.0	7.0%	233.3	7.0%	249.6	7.0%	267.1	7.0%	285.8	7.0%	305.8	7.0%
Transfer to Reginal Governments	204.9	212.7	3.8%	228.3	7.3%	243.4	6.6%	262.0	7.6%	286.2	9.2%	312.5	9.2%	331.1	6.0%	350.8	6.0%	371.7	6.0%
Net Revenues	**1,043.7**	**1,083.8**	**3.8%**	**1,168.3**	**7.8%**	**1,299.5**	**11.2%**	**1,440.7**	**10.9%**	**1,596.0**	**10.8%**	**1,744.1**	**9.3%**	**1,865.7**	**7.0%**	**1,995.9**	**7.0%**	**2,135.4**	**7.0%**
Total Expenditures	**1,158.7**	**1,241.3**	**7.1%**	**1,328.6**	**7.0%**	**1,404.3**	**5.7%**	**1,462.5**	**4.2%**	**1,549.0**	**5.9%**	**1,668.0**	**7.7%**	**1,777.8**	**6.6%**	**1,881.8**	**5.8%**	**2,011.4**	**6.9%**
Primary Expenditures	**1,158.1**	**1,241.2**	**7.2%**	**1,328.6**	**7.0%**	**1,389.5**	**4.6%**	**1,462.5**	**5.3%**	**1,549.0**	**5.9%**	**1,654.1**	**6.8%**	**1,763.1**	**6.6%**	**1,881.8**	**6.7%**	**2,011.4**	**6.9%**
Mandatory Spendings	**945.9**	**1,007.6**	**6.5%**	**1,089.5**	**8.1%**	**1,151.3**	**5.7%**	**1,208.9**	**5.0%**	**1,278.6**	**5.8%**	**1,346.4**	**5.3%**	**1,412.4**	**4.9%**	**1,481.8**	**4.9%**	**1,554.6**	**4.9%**
Payroll	237.6	270.4	13.8%	294.0	8.7%	313.2	6.5%	328.9	5.0%	345.3	5.0%	362.6	5.0%	378.9	4.5%	395.9	4.5%	413.7	4.5%
Social Security benefits	**436.3**	**507.8**	**16.4%**	**574.0**	**13.0%**	**630.0**	**9.8%**	**674.8**	**7.1%**	**726.3**	**7.6%**	**769.9**	**6.0%**	**812.2**	**5.5%**	**856.9**	**5.5%**	**904.0**	**5.5%**
Other Mandatory Spendings	**272.1**	**229.3**	**-15.7%**	**221.6**	**-3.4%**	**208.1**	**-6.1%**	**205.3**	**-1.3%**	**207.0**	**0.8%**	**214.0**	**3.4%**	**221.4**	**3.4%**	**229.0**	**3.4%**	**236.8**	**3.4%**
Workers support fund (FAT)	47.3	50.6	7.0%	60.1	18.7%	64.0	6.5%	67.8	6.0%	71.2	5.0%	74.8	5.0%	77.4	3.5%	80.1	3.5%	82.9	3.5%
Assistance Benefits (LOAS e RMV)	43.4	47.7	10.0%	52.6	10.4%	56.1	6.5%	59.5	6.0%	62.4	5.0%	65.5	5.0%	67.8	3.5%	70.2	3.5%	72.7	3.5%
Economic subsidies	112.2	68.7	-38.8%	43.2	-37.2%	19.2	-55.6%	9.2	-52.2%	6.2	-32.7%	4.4	-29.2%	4.4	0.0%	4.4	0.0%	4.4	0.0%
Bolsa Família	26.4	28.1	6.3%	29.8	6.3%	31.3	4.8%	33.1	6.0%	35.1	6.0%	37.2	6.0%	38.5	3.5%	39.9	3.5%	41.3	3.5%
Others	42.8	34.2	-20.0%	35.9	4.8%	37.6	4.8%	35.7	-5.0%	32.1	-10.0%	32.1	0.0%	33.3	3.5%	34.4	3.5%	35.6	3.5%
Non-Mandatory Spendings	**212.2**	**233.6**	**10.1%**	**239.1**	**2.3%**	**238.2**	**-0.4%**	**253.6**	**6.5%**	**270.3**	**6.6%**	**307.7**	**13.8%**	**350.6**	**14.0%**	**400.0**	**14.1%**	**456.8**	**14.2%**
Capital expenditures	**56.7**	**51.6**	**-9.0%**	**55.7**	**8.0%**	**58.5**	**5.0%**	**67.3**	**15.0%**	**77.4**	**15.0%**	**89.0**	**15.0%**	**102.3**	**15.0%**	**117.7**	**15.0%**	**135.3**	**15.0%**
Other curent expenditures	155.5	182.0	17.1%	183.4	0.7%	179.7	-2.0%	186.3	3.7%	193.0	3.6%	218.7	13.3%	248.3	13.5%	282.3	13.7%	321.5	13.9%
Health	**83.7**	**90.4**	**8.0%**	**99.3**	**9.8%**	**105.7**	**6.5%**	**119.0**	**15.0%**	**129.4**	**15.0%**	**148.8**	**15.0%**	**171.1**	**15.0%**	**196.8**	**15.0%**	**226.3**	**15.0%**
Education	**27.3**	**29.5**	**8.0%**	**32.4**	**9.8%**	**34.5**	**6.5%**	**38.8**	**15.0%**	**42.2**	**15.0%**	**48.5**	**15.0%**	**55.8**	**15.0%**	**64.2**	**15.0%**	**73.8**	**15.0%**
Other expenditures	44.4	42.2	-5.0%	38.0	-10.0%	38.0	0.0%	28.5	-25.0%	21.4	-25.0%	21.4	0.0%	21.4	0.0%	21.4	0.0%	21.4	0.0%
Aid for Regional government + Committed investments expenses net from Foreign asset repatriation revenue	-	19.9		13.8	-30.9%	1.6	-88.6%												
Fiscal Balance of central gov't (primary balance)	**115.0**	**157.5**		**160.3**		**104.7**		**21.8**		**(47.0)**		**(76.1)**		**(87.9)**		**(114.1)**		**(124.1)**	
Fiscal Balanceof central gov't (primary balance) % GDP	**1.9%**	**2.5%**		**2.4%**		**1.4%**		**0.3%**		**-0.5%**		**-0.8%**		**-0.8%**		**-1.0%**		**-1.0%**	
Net revenues ratio to GDP	**17.7%**	**17.4%**		**17.2%**		**17.5%**		**17.7%**		**17.8%**		**17.8%**		**17.7%**		**17.5%**		**17.3%**	
Total Expenditures ratio to GDP	**19.6%**	**19.9%**		**19.6%**		**18.9%**		**17.9%**		**17.3%**		**17.1%**		**16.8%**		**16.5%**		**16.3%**	

Sources: Finance Ministry and Santander estimates.

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