

## Brazil: Lessons and Possible Fiscal Proposals for 2027

- ▶ Brazil continues its historical pattern of relying predominantly on revenue-driven strategies to pursue fiscal balance without meaningfully addressing the structural dynamics of public spending. This approach has contributed to persistently high real interest rates and a low growth environment. Under current rules and assuming no course correction, the fiscal adjustment required to stabilize the gross public debt, currently around 4pp of GDP, is expected to increase meaningfully over time. A credible strategy will require a comprehensive review of Brazil's public budget and its fiscal rules. In this report, we outline a comprehensive fiscal adjustment proposal for Brazil that could be implemented starting in 2027.
- ▶ There are alternative strategies for fiscal consolidation, beginning with the pace of implementation. Empirical evidence shows that front-loaded adjustments tend to generate faster credibility gains, helping compress risk premia, while gradual processes often lose momentum over time. International experience also shows that expenditure-based consolidations are generally more effective in correcting fiscal imbalances and entail smaller activity costs than revenue-driven strategies—a particularly relevant point in Brazil's context of structurally high real interest rates. Simple, predictable, and binding expenditure rules typically outperform primary-balance or debt-based rules, as they focus directly on the underlying source of fiscal deterioration. In this context, an effective adjustment plan would combine measures with significant short-term impact alongside a stronger emphasis on expenditure restraint. Coupled with these measures, an expenditure rule anchored to the debt trajectory which would temporarily restore a zero real growth cap on primary spending could meaningfully increase the probability of a successful and durable fiscal consolidation.
- ▶ Delivering such an adjustment would require a broad set of measures, including difficult topics such as the indexation of expenditures to the minimum wage, revisions to constitutional spending floors, additional pensions and social-assistance reforms, reduction in subsidies, and a review of tax expenditures. Taken together, these measures could generate an improvement of 6.8pp of GDP in the primary balance by 2036 relative to a no-reform scenario, with roughly 70% of the adjustment coming from expenditure control. If fully implemented, the measures could bring the primary balance to a surplus of around 1.3% of GDP as early as 2028, rising to 3.7% of GDP by 2036, while placing public debt to a more favorable trajectory and creating the conditions for sustainable growth with lower real interest rates. The political feasibility of each measure varies, but elected officials—not technical analysts—are ultimately best positioned to assess what is politically viable at each point in time.

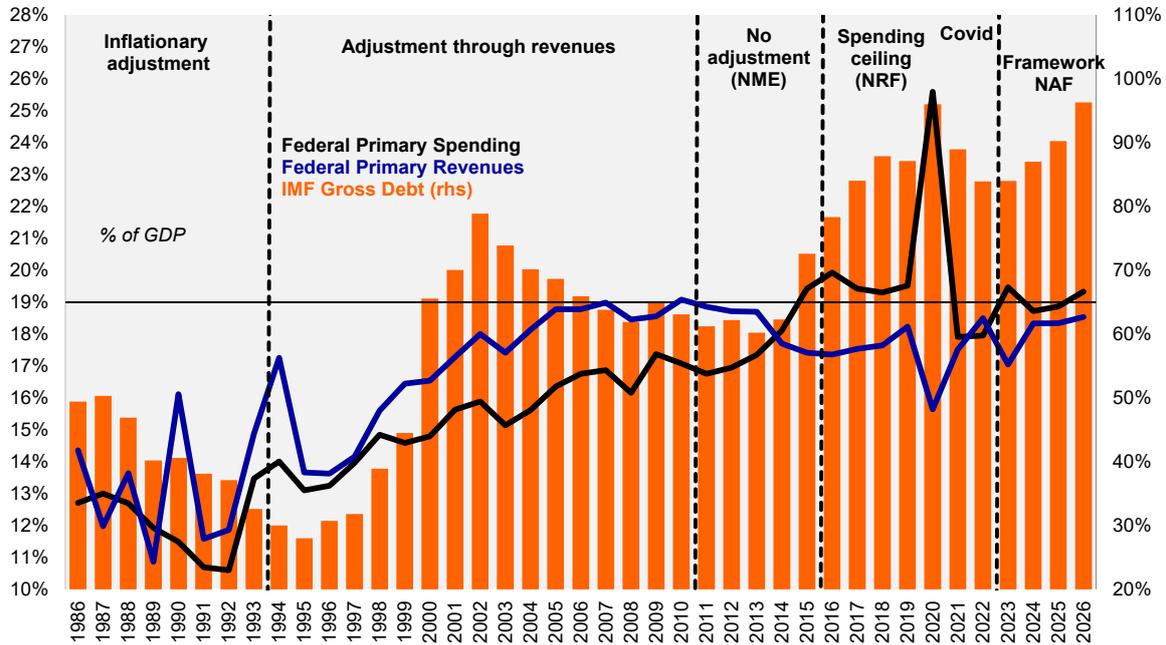
### 1 - Fiscal Regimes and the Size of the Required Adjustment

**Over the past several decades, Brazil has alternated between different fiscal strategies without structurally or durably resolving its public-finance imbalances.** Before the Real Plan (1994), fiscal was implicitly corrected through inflation. After stabilization, the adjustment relied on sharp tax burden increases, which proved unsustainable—politically and structurally—once favorable tailwinds such as China's boom and high commodity prices faded. In the absence of reform, persistent real expenditure growth (averaging 6% per year), revenue-reducing tax exemptions, and subsidized credit initiatives culminated in the 2014–2016 crisis.

The response was the most ambitious attempt to control spending: the expenditure ceiling, designed to shift fiscal policy's asymmetric bias and curb the growth of the state as relative to GDP, with the expectation of a decade-long lifespan. However, repeated exceptions eroded its credibility, and the rule was ultimately overridden by the Transition PEC in 2022. The New Fiscal Framework introduced greater flexibility, but its parameters do not guarantee debt stabilization without a substantial and sustained increase in revenues. As a result, Brazil remains tied to a model

centered on additional revenue mobilization rather than structural expenditure reform, perpetuating fiscal imbalances that keep real interest rates high and constrain economic growth.

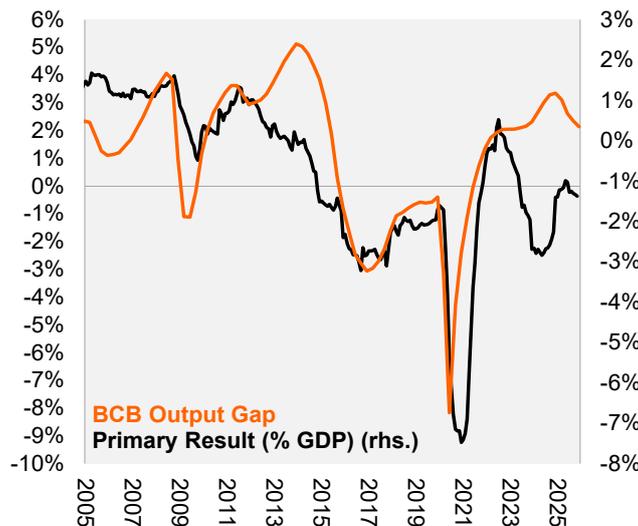
**Different fiscal regimes did not prevent the trend of increased spending.**



Source: National Treasury, Itaú

**In recent years, Brazil's fiscal trajectory has shown no meaningful signs of improvement.** The primary balance has remained between  $-0.5\%$  and  $-1.0\%$  of GDP, while primary revenue hovering around  $18\%$  of GDP, slightly above 2019 levels and close to its 2010 peak has inched up only modestly. This revenue growth has been offset by rising expenditure, currently near  $19\%$  of GDP and close to historic high (excluding the pandemic). In practice, the country has opted to increase the size of the state, with higher expenditures partially counterbalanced by revenue-recovery initiatives. Many of these initiatives are technically justified, such as reversing tax distortions and curbing avoidance, they have proved insufficient to stabilize the primary balance even in the context of growth above potential.

**Primary deficit despite positive output gap.**

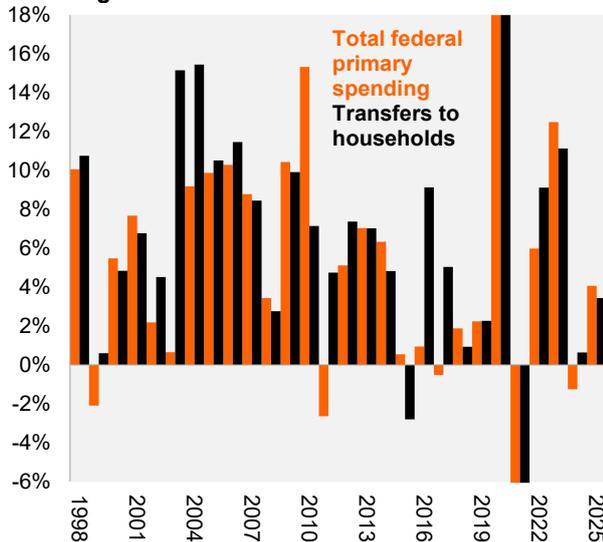


Source: National Treasury, Brazilian Central Bank, Itaú

**The recent fiscal dynamics reflect both the design flaws and the practical execution of the current framework.** Although the rule sets a formal cap of 2.5% for real annual expenditure growth, spending components most relevant for economic activity—such as social transfers—have been growing at roughly 6%, driven by difficulties in controlling the number of pension and social-assistance beneficiaries and by real increases in the minimum wage. As a result, fiscal policy remains expansionary even when the economy is operating above potential—contrary to best practice—while discretionary spending is compressed, raising political pressure for flexibility in aggregate limits.

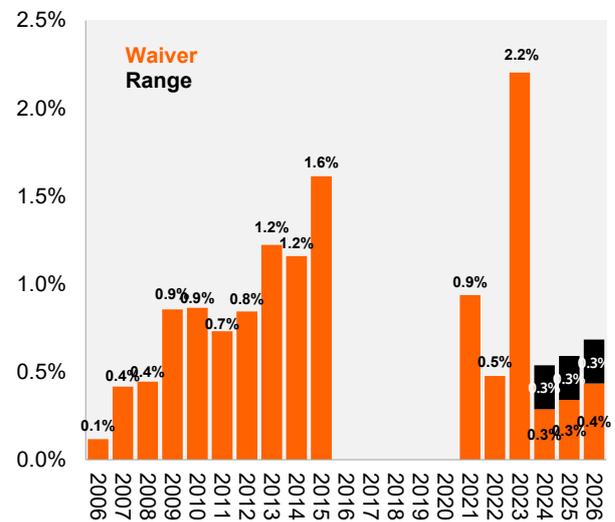
**The proliferation of exceptions and exclusions from spending caps and primary-balance targets has further eroded transparency and predictability.** Frequent carveouts signal inconsistency with the framework, despite the presence of tolerance bands intended to absorb shocks. Moreover, recent practice has been to steer fiscal policy toward the lower bound of the target band rather than the midpoint, effectively reducing the buffer designed for exceptional circumstances. Ultimately, insufficient discipline in expenditure dynamics, combined with recurring delays in delivering promised fiscal improvements, has contributed to higher risk premium and structurally elevated real interest rates. These trends reinforce the need for a stronger and more credible fiscal anchor capable of restoring confidence in Brazil’s medium-term fiscal trajectory.

**Expenses related to transfers to households are increasing.**



Source: National Treasury, Itaú

**Waivers on fiscal targets are increasing again**

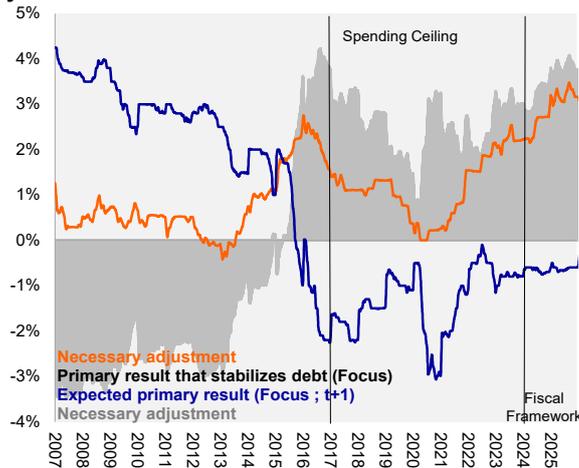


Source: National Treasury, Itaú

**Therefore, the current rules have produced an expansionary fiscal stance that raises both growth and interest-rate expectations, increasing the effort required to stabilize public debt.** According to the basic debt-dynamics (d) equation, stabilization requires a primary surplus (s) equal to real interest rate (r) minus growth rate (g) multiplied by the debt stock. Focus survey data show that, while the expenditure ceiling cycle led to a substantial drop in the perceived fiscal adjustment need, that requirement has risen again under the current framework. It is now estimated at about 4pp of GDP, consistent with real interest rates near 6% and potential GDP growth around 2%.

$$\Delta d = d * (r - g) - s$$

**Fiscal framework has not been able to reduce the adjustment needed to stabilize the debt.**

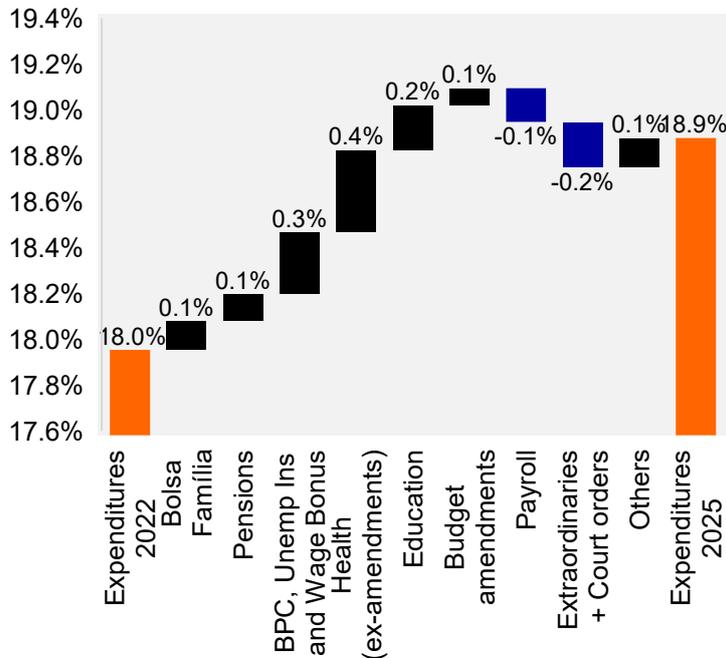


Source: Brazilian Central Bank, Itaú

**Even the modest adjustment embedded in the current framework is not guaranteed, given the behavior of mandatory expenditures.** A large share of spending is indexed to the minimum wage or tied to constitutional rules, and population aging, alongside weak controls and judicial decisions, tends to increase the number of pension and social-assistance beneficiaries.

**Indeed, since 2022, most expenditure categories have risen as a share of GDP.** The increase in federal primary spending from 18% of GDP in 2022 to 18.9% in 2025 has been driven by minimum-wage-indexed components (such as pensions, BPC, unemployment insurance, and the Wage Bonus) and constitutionally mandated health and education spending. Personnel expenditures are among the few categories that declined, but they are expected to rise again in 2026 following above-inflation wage adjustments and recent hiring.

**A virtually generalized increase in spending as a percentage of GDP since 2022.**



Source: National Treasury, Itaú

**Under current rules, structural dynamics point to automatic fiscal deterioration, with expenditures rising around 3% per year in real terms.** This reflects assumptions such as: (i) the continuation of current minimum-wage rules and benefit indexation; (ii) pension-beneficiary growth around 3% per year; (iii) inflation-only wage adjustments

and no net hiring for civil servants; (iv) health and education spending growing with revenues and a 2% GDP trend; (v) other expenditures (e.g., *precatórios*, subsidies, Bolsa Família) growing 1% in real terms. This pace exceeds the 2.5% cap in the fiscal framework, suggesting that a no-reform scenario will be more accurately captured by a line-by-line projection rather than by the aggregate rule limit.

**Under current rules, spending grows by at least 3% per year in real terms.**

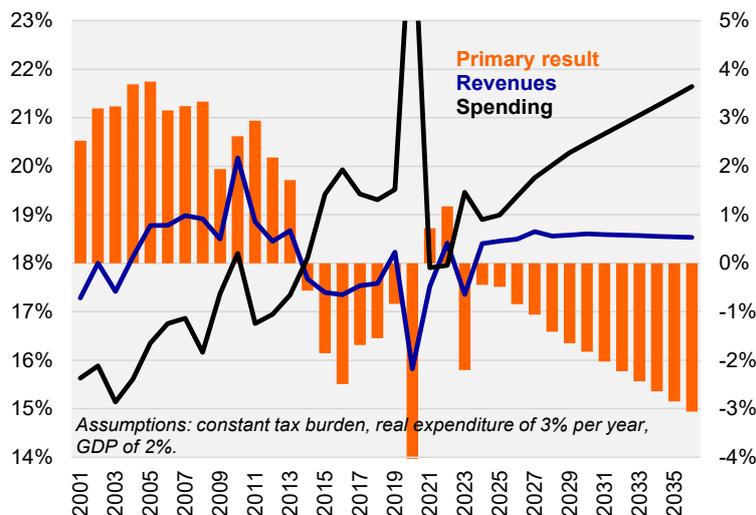
function (Soc Sec+ BPC quantum & servants)		Current minimum wage rule (Inflation + GDP, limited to 2.5%)			
		Quantum Growth Soc Sec+ BPC			
		1.0%	2.0%	3.0%	4.0%
Servants (~20% of total spending) (readjustment)	0% nominal + 50% rep.	1.4%	1.9%	2.4%	2.9%
	0% real + 50% rep.	2.0%	2.5%	3.0%	3.4%
	0% real + 100% rep.	2.1%	2.6%	3.1%	3.6%
	0.5% real + 100% rep.	2.2%	2.7%	3.2%	3.7%
	0.5% real + 150% rep.	2.4%	2.9%	3.4%	3.9%

Memo: other spending 30% (*precatórios*, subsidies, bolsa família, health & education) ~1.5% real per year ; investment = ct % GDP

\* GDP = 2.0% a.a

**In this scenario, the primary deficit could reach roughly 3% of GDP by 2036.** Considering GDP growth at 2% (near potential), the primary deficit widens by about 0.2–0.25pp of GDP per year. This projection reflects current dynamics; it is not predetermined but avoiding it requires policy correction.

**Without reforms, primary deficit will reach 3% of GDP in 2036**



Source: Brazilian Central Bank, Itaú

**This backdrop is further worsened by the ongoing deterioration in global fiscal outlook.** Advanced economies have expanded public debt since the pandemic through increased social and defense spending. As consequence, global interest rates rose, raising financing costs for emerging economies. Brazil stands out negatively: its public-debt level—near 90% of GDP on the IMF metric—is among the highest in emerging markets and well above the 40–60% range typical in Latin America and the roughly 50% observed among investment-grade emerging economies peers. This increases Brazil’s risk premium and structural interest rates, thereby constraining economic growth (see [Macro Vision: Global fiscal deterioration and the size of the challenge ahead](#)).

**As a result, the fiscal adjustment required to stabilize the debt over the next decade may reach very high levels, depending on real interest rates.** This underscores the need for not only primary-balance improvements but also a credible strategy capable of lowering the risk premium amid a backdrop of higher global rates. A necessary but not sufficient condition is redesigning the current fiscal rules. Credibility gains are larger the more front-loaded the adjustment is. A new fiscal rule may buy some time, but without measures to curb mandatory expenditures and deliver meaningful near-term improvement in the primary balance, credibility gains will be limited, and the cost of adjustment may continue to rise.

**Size of primary fiscal adjustment in p.p. of GDP to stabilize public debt at 80% of GDP**

	<b>With 2025 primary result of -0.5% of GDP</b>	<b>With primary result of -3.1% of GDP without reforms in 2036</b>
<b>With 2% GDP , current real rates of 7%</b>	4.6%	7.1%
<b>With 2% GDP , future Focus real rates of 6%</b>	3.8%	6.3%
<b>With 2% GDP , real rates of 5% (i.e, with credibility gains)</b>	3.0%	5.5%

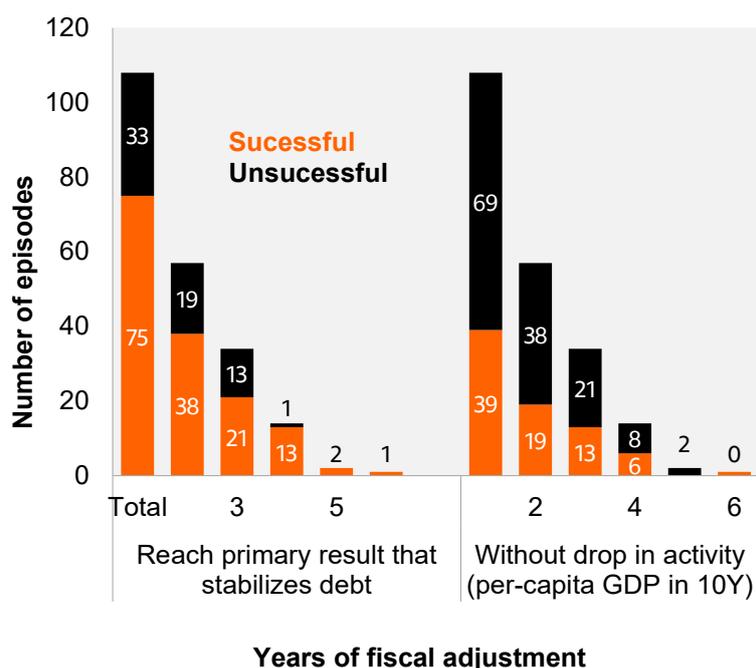
## 2 - Lessons from Fiscal Adjustment Plans and the Role of Credibility

**Governments typically alternate between two main strategies for fiscal consolidation: gradual adjustments, implemented slowly and continuously over several years, and accelerated (or front-loaded) adjustments, which concentrate fiscal effort in the first years of the plan.**

**Faster fiscal adjustments tend to generate more immediate credibility gains.** They signal a firm commitment to correcting imbalances, reducing risk premia, market interest rates, and inflationary pressures. This effect is particularly important in emerging economies, where interest rate sensitivity to fiscal conditions is higher and external shocks are more frequent. Concentrating the initial effort also mitigates “reform fatigue,” a common challenge in protracted adjustments that become diluted by political cycles and changes in government. For this reason, gradual adjustments often need to be supported by fiscal rules that are simple, binding, and predictable to preserve credibility. On the other hand, excessively abrupt adjustments can have short-term impacts on activity and employment, particularly when not grounded in structural reforms capable of lowering real interest rates.

**World Bank evidence suggests that governments struggle to sustain fiscal effort over long periods, but when they do, success rates rise sharply.** The study *A Primer on Restoring Fiscal Space and Sustainability* identifies 108 adjustment episodes between 1980 and 2023, with an average duration of 2.7 years. However, when the adjustment is sustained for four years or more, the probability of stabilizing debt rises from 67% to over 90%. When considering only adjustments that did not lead to declines in activity (measured by the 10-year average of per-capita GDP before the adjustment), success rates drop, indicating that quick fiscal consolidation typically entails some short-term economic cost.

**It is historically difficult to maintain a fiscal adjustment effort for an extended period.**



Source: World Bank, Itaú

**A further dimension of fiscal adjustments is their composition—whether based on revenue increases or expenditure reductions.**

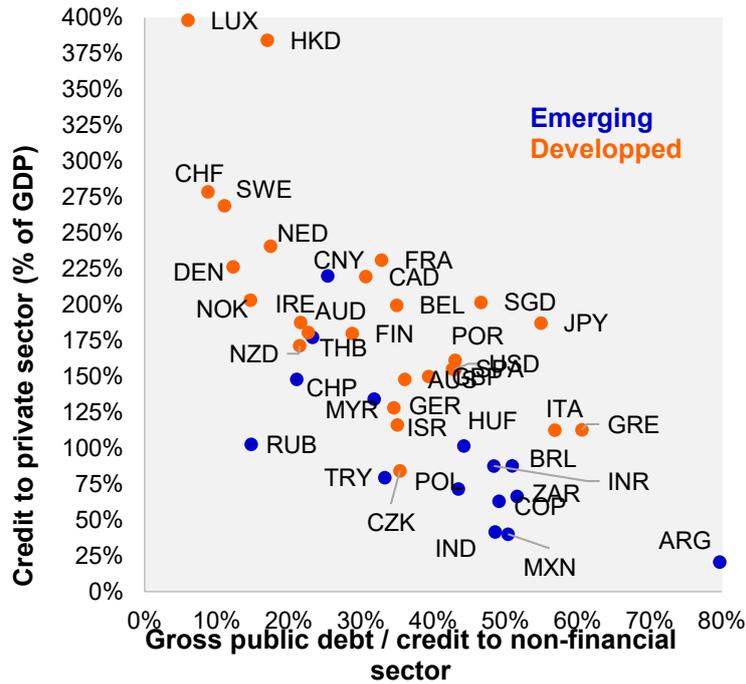
**Expenditure-based adjustments tend to last longer and be more effective in stabilizing public debt.** By curbing expenditure growth, governments address the structural source of fiscal imbalances, which lowers risk premia and contributes to lower real interest rates. According to the World Bank, 83% of expenditure-based adjustments succeeded in stabilizing debt, compared to just 49% of revenue-based adjustments.

**Another advantage of expenditure-based adjustments is that they are empirically less recessionary (and in some cases even neutral) compared to tax-based consolidations.** Studies by Alberto Alesina and Francesco Giavazzi<sup>1</sup> analyzing over 200 consolidation episodes in OECD countries show that a 1% of GDP spending-based adjustment reduces growth by only 0.25pp, whereas a tax-based adjustment of the same size reduces growth by 2–3pp and can prolong recessions for up to four years. Spending cuts tend to boost confidence, reduce expectations of future tax hikes, and stimulate private investment and consumption, offsetting part of the contractionary effect.

**In addition, curbing public spending frees resources in credit markets (*crowding-in effect*) and reduces inflationary pressure, supporting long-term growth.** Broadly, countries with high public debt relative to the size of their non-financial credit markets exhibit lower private-sector credit compared to GDP.

<sup>1</sup> “The Output Effect of Fiscal Consolidation Plans” (Alesina, Favero e Giavazzi, 2015) and “Effects of Austerity: Expenditure- and Tax-based Approaches” (Alesina, Favero e Giavazzi, 2019)

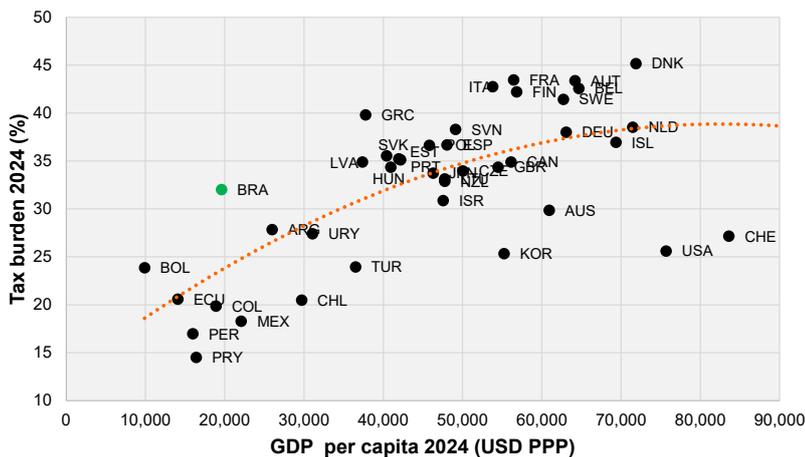
**Countries with high levels of public debt have less developed private credit markets.**



Source: BIS, Itaú

For Brazil, these findings suggest that a credible fiscal plan should combine rapid initial results with structural reforms focused on expenditure control. This does not preclude implementing justified revenue measures. Revenue-focused initiatives can complement adjustment—especially when aimed at reducing tax exemptions, subsidies, and distortions, where empirical evidence shows smaller negative growth effects<sup>2</sup>. However, such measures are unlikely to substitute structural expenditure containment, particularly in a country like Brazil, whose tax burden is already high relative to its income level.

**Brazil tax burden is high for its income level**



Source: OECD, IMF, Itaú

<sup>2</sup> A study by IMF researchers (Dabla-Norris, M. E., & Lima, F. (2018). Macroeconomic effects of tax rate and base changes: Evidence from fiscal consolidations) examined around 2,500 tax measures in 10 OECD countries and found that measures aimed at broadening the tax base (such as reducing tax expenditures) lead to smaller declines in GDP and employment (multipliers of 0.3 in the first year and 0.4 in the second year) than rate-increase measures applied to the same base (multipliers of 1.2 and 1.6 after two years).

**Additionally, the credibility of the adjustment strategy is as important as the size of the adjustment itself, since expectations of solvency and sovereign risk directly influence long-term interest rates, especially in emerging economies.** Empirical evidence shows that credible consolidation plans reduce sovereign spreads and make fiscal adjustment less contractionary, while persistent increases in deficits and debt push interest rates higher over time—a pattern more pronounced in countries with high indebtedness and amid global fiscal deterioration. Since the pandemic, even advanced economies have displayed heightened sensitivity of long-term interest rates to fiscal events. In Brazil, the pattern is similar: fiscal consolidation measures reduce real-rate expectations, while spending-flexibility initiatives or credibility-weakening signals raise them ([see Macro Vision: Global fiscal deterioration and the size of the challenge ahead](#)).

**We estimate that a credible adjustment strategy capable of slowing expenditure growth and lowering the risk premium to 2017–2019 levels could bring long-term real interest rates to around 5% and reduce the required fiscal effort by 1.5–2.0pp of GDP.** Conversely, in a more adverse scenario where spending continues to grow at current rates and the risk premium worsens as it did in 2015, real interest rates could approach 9%, an unsustainable outcome. Importantly, in all scenarios, Brazil is starting from a more unfavorable position than in the pre-pandemic period, with global interest rates about 2pp higher. This implies that even in benign scenarios, real rates are unlikely to return to the 3.5–4.0% levels observed in 2019; the external environment imposes a structurally higher floor for domestic rates.

Real Rates NTNB 2045		Risk Premium = 2017-19			Current Risk Premium			Current Risk Premium + Δ 2015		
		US 10Y Real			US 10Y Real			US 10Y Real		
Expenditures y/y real (4Y MA)	0%	0.0%	1.0%	2.0%	0.0%	1.0%	2.0%	0.0%	1.0%	2.0%
	0%	3.9%	4.5%	5.1%	5.1%	5.6%	6.2%	6.9%	7.5%	8.1%
	1%	4.1%	4.7%	5.3%	5.3%	5.8%	6.4%	7.2%	7.7%	8.3%
	2.5%	4.5%	5.0%	5.6%	5.6%	6.2%	6.7%	7.5%	8.0%	8.6%
	4%	4.8%	5.3%	5.9%	5.9%	6.5%	7.0%	7.8%	8.4%	8.9%
5%	5.0%	5.6%	6.1%	6.1%	6.7%	7.2%	8.0%	8.6%	9.1%	

### Comparison of fiscal adjustment strategies

	Upsides	Downsides
<b>"Front-loaded" Adjustment</b>	(i) Immediate credibility gain with a faster decline in the risk premium (ii) Lower risk of reversal and exposure to electoral cycles (iii) Prevents abrupt, forced adjustments in the future	(i) Possibly higher short-term economic cost (ii) Depends on broad initial consensus (support in Congress and society)
<b>"Back-loaded" Adjustment</b>	(i) Possibly lower short-term economic cost (ii) More consistent with structural reforms, which usually involve long transitions	(i) Higher risk of fatigue, increasing flexibilizations, creative accounting, and reversals during electoral cycles (ii) Greater dependence on credibility, which may vary over time (iii) International evidence shows low survival rates (iv) Possibility that recurring new measures affect expectations and investment (v) May require recalibration due to domestic and external shocks
<b>Expenditure-based Adjustment</b>	(i) Greater credibility gains enable a faster reduction in real interest rates if focused on mandatory expenditures (ii) International evidence suggests they are less recessionary (iii) Lower risk of tax evasion and avoidance	(i) Requires broader political consensus because it generally involves more constitutional rules and long transition periods
<b>Revenue-base Adjustment</b>	(i) Easier to generate short-term effects	(i) Limited credibility leads to a smaller reduction in the risk premium (ii) Greater tax uncertainty may harm investment (iii) May generate incentives for informality (iv) Higher risk of evasion and avoidance (v) International evidence suggests they are more recessionary

## 3 – An Ideal Fiscal Rule

**No fiscal rule can fully discipline governments under all circumstances, nor can any framework endure without broad political support. Still, fiscal rules tend to be more effective when they are simple, predictable, and binding.** Brazil’s experience illustrates this clearly: despite being a constitutional rule and initially effective, the spending cap ultimately faced political resistance, lost credibility through repeated amendments and exceptions, and the same pattern is now repeating—starting from a weaker position—under the current fiscal framework.

**Both international and domestic evidence suggest that expenditure rules outperform primary-balance or debt-based rules.** They directly target a variable under greater government control, are less pro-cyclical, and prevent temporary revenue gains from becoming permanent spending increases. Brazil's experience between 2001 and 2016 shows that the primary-balance regime failed to stabilize public debt, was frequently relaxed, and ultimately contributed to tax-burden increases and weaker expenditure control. The current framework reproduces these problems by linking spending growth to revenue, expanding exceptions, and allowing fiscal expansion even in a heated economy—thereby contributing to elevated real interest rates and credibility erosion. Debt-limit rules also present major shortcomings, as debt levels depend on variables outside policymakers' direct control, such as growth and interest rates, and can generate distortions depending on the concept adopted.

**A more promising middle-ground approach is an expenditure rule explicitly linked to the debt trajectory.** The underlying premise is that the priority of any fiscal rule should be to maintain public debt at a sustainable level and on a benign path. Without debt sustainability, the state is unlikely to deliver quality public services or social assistance in the long run.

**For such a rule to work effectively, it must first be simple, relying on observable parameters that are already monitored as standard references, such as gross general-government debt as the anchor for the debt target, and total federal primary expenditure as the controlled variable.** Second, it must be predictable, with few exceptions and well-defined escape clauses, where the exceptions embedded in the current fiscal framework provide a reasonable reference point. Third, the rule must be binding, including automatic correction mechanisms in cases of non-compliance.

**A key precondition for the regime to function is the absence of changes over time to the debt metric and the scope of expenditures under the rule—problems that previously undermined the primary-balance metric, the spending cap, and now the current framework.** Credibility in any regime cannot survive excessive accounting tinkering. Changing the rule should become as serious and exceptional an act as altering the methodology of the IPCA used to assess inflation-target compliance.

**Once the objective and structure of the rule are defined, the allowed pace of expenditure growth must be calibrated through transparent simulations reflecting the time required to bring debt to the desired level.** These exercises should rely on broadly accepted parameters and clearly communicate the trade-offs involved. Naturally, the further the starting debt position is from the target, the more restrictive the expenditure rule must be.

**Simulations indicate that permitting real expenditure growth of 2.5% per year does not offer a robust prospect of debt stabilization, unless one assumes implausibly strong growth or revenue performance.** The table below illustrates the time required for debt to stabilize and the associated stabilization level under various assumptions for spending growth, GDP growth, and real interest rates—assuming no revenue gains from future tax measures.

**By contrast, a less gradual adjustment, such as temporarily reinstating zero real growth in primary spending, materially improves the probability of stabilization and can later be relaxed if positive surprises materialize.**

When and at what level does the gross debt stabilize?

GDP / Real Rate	Fiscal Framework 2.5%				1% real spending growth				0% real growth			
	4%	5%	6%	7%	4%	5%	6%	7%	4%	5%	6%	7%
2.0%	2052 ; 110%	Diverge	Diverge	Diverge	2031 ; 87%	2037 ; 97%	2046 ; 119%	2090 ; 236%	2028 ; 84%	2031 ; 88%	2034 ; 96%	2039 ; 110%
2.5%	2037 ; 90%	2055 ; 117%	Diverge	Diverge	2028 ; 83%	2031 ; 88%	2035 ; 96%	2040 ; 111%	2027 ; 82%	2029 ; 85%	2030 ; 89%	2033 ; 96%
3.0%	2029 ; 83%	2035 ; 90%	2045 ; 108%	2072 ; 174%	2027 ; 82%	2028 ; 84%	2030 ; 88%	2033 ; 95%	2026 ; 81%	2027 ; 83%	2029 ; 86%	2030 ; 90%

**A critical decision is setting the target debt level. Beyond simple stabilization, one option is to bring debt closer to the average of investment-grade emerging economies, which would enhance the country's ability to attract investment and ultimately reduce the economy's cost of capital.** Based on S&P's rating classifications, Brazil would need to bring its gross debt-to-GDP ratio from 88% in 2024 (IMF metric) to roughly 50%. The key point is that without a major reassessment by rating agencies of what constitutes sustainable debt for an emerging economy, merely stabilizing debt around 80% of GDP is insufficient.

Simulations show that lowering debt levels solely through slower expenditure growth—without measures to reduce expenditure levels or raise revenue—would be very difficult, given the need for a prolonged and politically unsustainable adjustment effort.

**When the debt will reach 80% / 60% / 50% of GDP**

GDP/ real rates	Fiscal Framework 2.5%				1% real spending growth				0% real spending growth			
	4%	5%	6%	7%	4%	5%	6%	7%	4%	5%	6%	7%
2.0%	2085 / 2092 / 2094	Never / Never / Never	Never / Never / Never	Never / Never / Never	2042 / 2049 / 2052	2052 / 2057 / 2060	2068 / 2072 / 2073	Never / Never / Never	2034 / 2041 / 2043	2039 / 2044 / 2046	2045 / 2049 / 2051	2054 / 2057 / 2058
2.5%	2056 / 2066 / 2069	2085 / 2091 / 2093	Never / Never / Never	Never / Never / Never	2034 / 2041 / 2044	2039 / 2046 / 2048	2047 / 2052 / 2053	2057 / 2061 / 2062	2031 / 2037 / 2039	2034 / 2040 / 2042	2038 / 2043 / 2045	2043 / 2047 / 2049
3.0%	2037 / 2048 / 2052	2049 / 2057 / 2060	2067 / 2072 / 2074	Never / Never / Never	2030 / 2038 / 2040	2034 / 2040 / 2042	2038 / 2044 / 2046	2044 / 2048 / 2050	2029 / 2035 / 2037	2031 / 2037 / 2039	2034 / 2039 / 2041	2038 / 2042 / 2044

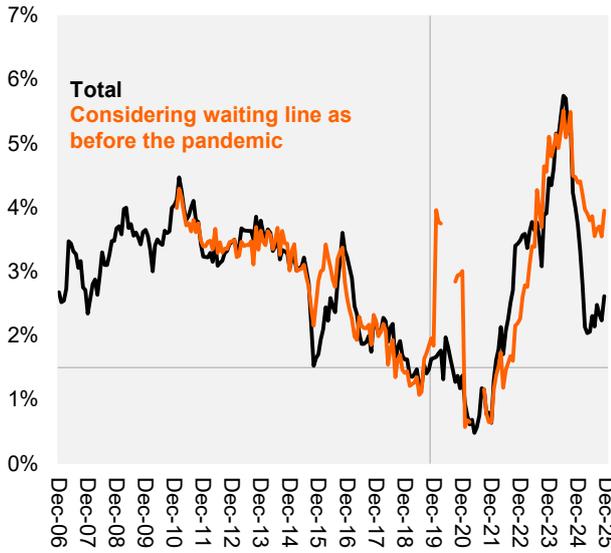
#### 4 – Measures Required to Implement a Fiscal Adjustment

A program of fiscal adjustment would encompass measures that, taken together, imply an improvement of 6.8 percentage points of GDP in the primary balance by 2036, combining expenditure reduction (4.7 p.p.) and revenue increases (2.1 p.p.). Approximately 40% of the overall effort (2.7 p.p. of GDP, of which 1.4 p.p. on the expenditure side) would be concentrated already in 2027–2028, allowing the primary balance to reach a surplus above 1% of GDP in 2028 if all measures were fully adopted, precisely because it would combine actions with rapid impact and gradual reforms that sustain credibility over time. The table at the end of this section lists the measures and presents their effects in the first two years and by 2036.

Within the expenditure block, two reforms stand out as particularly impactful: the de-indexation of the minimum wage (1.2% of GDP in 2036) and of constitutionally mandated floors currently linked to revenue, such as health and education (0.4% of GDP in 2036), which would instead be adjusted by inflation. The first change eliminates a fiscal-expansion mechanism disconnected from the state’s financing capacity and the distortion whereby productivity gains among active workers are transferred to inactive beneficiaries—something that does not occur in most countries. Ideally, de-indexation should separate the adjustment rule for benefits paid to active workers (the formal labor market floor) from those paid to inactive beneficiaries. Regarding the second measure, we assess that it helps make public spending less pro-cyclical and more flexible, contributing to shifting the focus from spending volume to spending quality, and should involve at least the unification (if not the elimination) of these floors, given ongoing demographic changes. Such measures inevitably entail political cost, but fiscal deterioration and its inflationary implications would impose significantly higher and socially damaging costs.

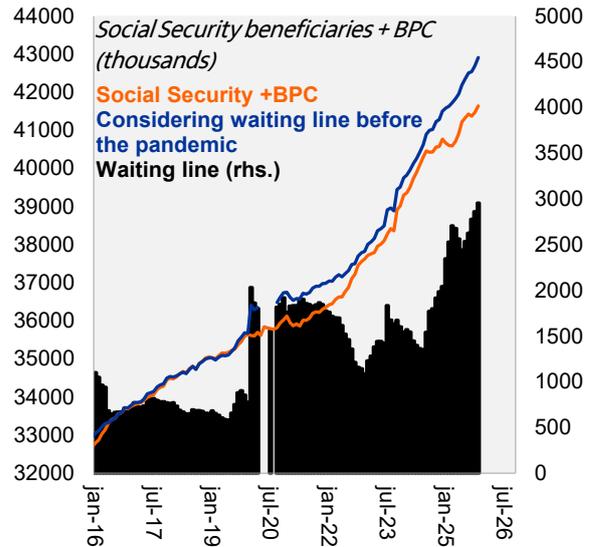
In the pension system, a new parametric reform is warranted, aiming to slow beneficiary growth to around 1.5% per year, which would generate savings of 1.0% of GDP in 2036. Even after the 2019 reform, the system faces pressure from population aging, rising life expectancy, and enforcement challenges. Since the pandemic, beneficiary growth has exceeded expectations under the reform (4% vs. the expected 1.5% to 2.0% per year). Recently, some moderation has occurred, but at the cost of a growing backlog of pending claims. Moreover, Brazil’s pension spending remains above levels consistent with its demographic profile, suggesting eligibility rules remain lenient by international standards, a trend reinforced by the increasing judicialization of benefit decisions.

**Pension beneficiaries growth distorted by increase waitingline.**



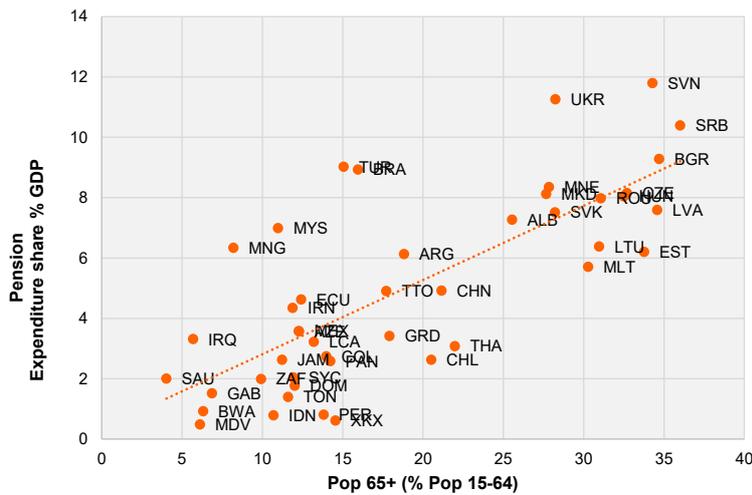
Source: Ministério Previdência, Itaú

**Increase in pensions waiting line**



Source: Ministério Previdência, Itaú

**Brazilian spending on pensions is high for the country's demographics.**



Source: World Bank, Itaú

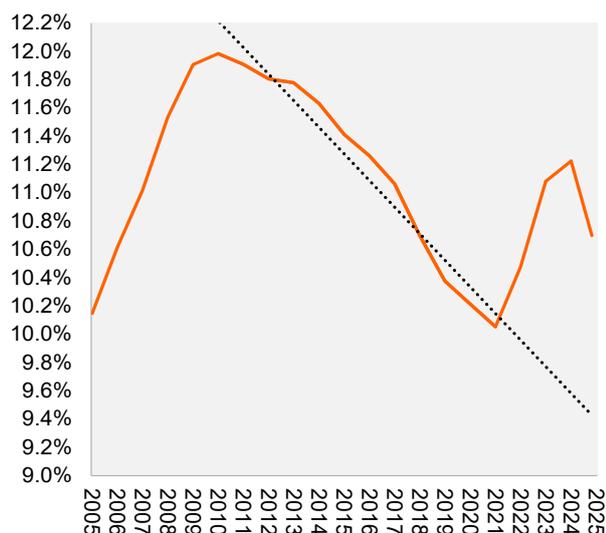
To slow the growth of the beneficiary pool, an adjustment program could raise the minimum retirement age to 68, converge rules currently differentiated for women and rural workers, and tighten survivor-pension eligibility criteria for higher-income families. For retirement benefits, the transition should remain firm, maintaining the schedule established by the 2019 reform (EC 103), ending around 2031–33. Gender equalization is already standard in most OECD countries, justified by evidence that women live longer on average than men: currently, among 38 countries, only nine maintain differentiated rules, and only six (including Brazil) maintain gaps of at least three years. The rural modality, given mechanization and enforcement challenges, facilitates distortions, early retirements, and opportunistic migration, functioning in practice as a poorly targeted income-transfer program. For survivor pensions, limiting benefit accumulation based on the dependent’s income and assets and increasing minimum contribution periods would deepen the 2019 reform.

For the BPC (social-assistance benefit), an adjustment would involve changes to both eligibility parameters and benefit levels for both the old-age (0.21% of GDP in 2036) and disability (0.19% of GDP). A proposal for the old-age benefit is to raise the minimum eligibility age to 70 (two years above proposed contributory retirement) and

converge its value to Bolsa Família. The goal is to preserve the program’s social assistance nature, focusing benefits on the most vulnerable elderly groups and age cohorts with lower labor-market participation capacity, while reducing incentive distortions and reinforcing the fiscal sustainability of a policy not financed by individual contributions. For the disability benefit, one possible change is to link payments to the severity of disability, with the average benefit converging to 80% of the minimum wage over ten years, which would require stronger medical examinations and explicit legal classification of disabilities eligible for the benefit, reducing arbitrariness and judicialization. In both cases, the goal is to restore beneficiary levels to pre-pandemic trends relative to the target population.

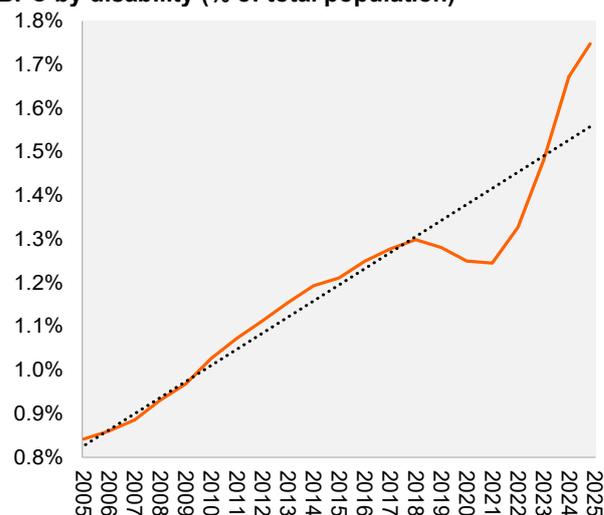
**BPC could return to pre-pandemic trends as a proportion of its target population.**

**BPC by age (% population + 65y)**



Source: Ministério da Previdência Social, Itaú

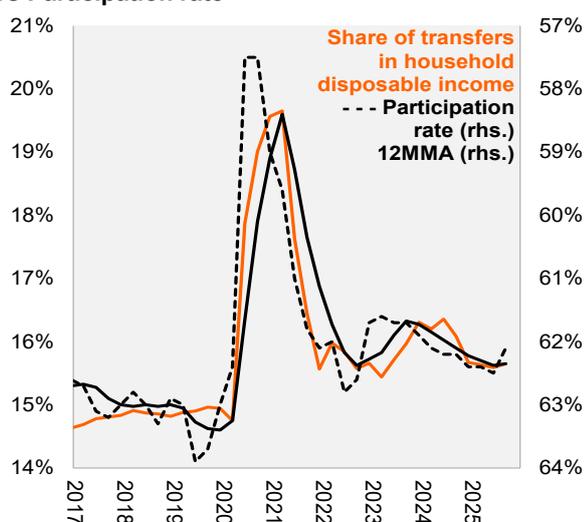
**BPC by disability (% of total population)**



Source: Ministério da Previdência Social, Itaú

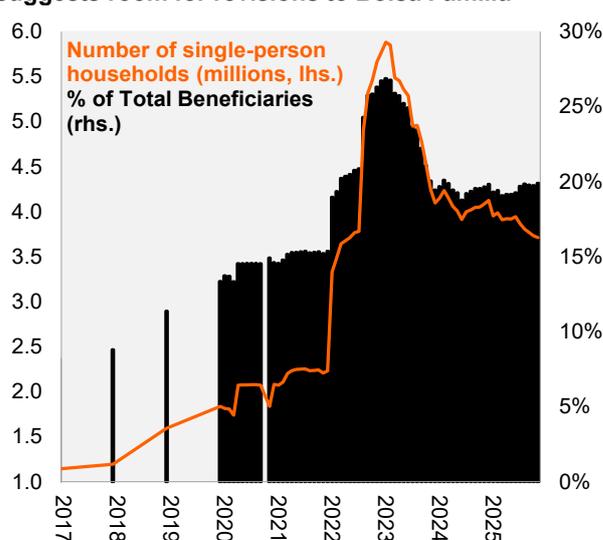
**Within social assistance, strengthening the targeting of Bolsa Família is an important component of a comprehensive adjustment strategy.** Despite its essential role in reducing extreme poverty, the program expanded significantly after the pandemic, with the average benefit rising from 20% to 45% of the minimum wage (and from 10% to 20% of the average wage) and beneficiaries rising from 13 million in 2019 to around 19 million in 2025, with single-person households increasing from 13% to 20% of the total. The reform reflects the need to adapt the program to recent dynamics in the Brazilian labor market. There is evidence that rising transfer expenditures are correlated with declining labor-force participation rates. By preserving purchasing power via inflation-based adjustments (which would reduce the benefit as a share of the average wage) and gradually reducing the number of beneficiaries to pre-pandemic levels, it would be possible to lower expenditures by around 0.5% of GDP over ten years.

**Share of transfers in households disposable income vs Participation rate**



Source: National Treasury, IBGE, Itaú

**The high number of single-person households suggests room for revisions to Bolsa Familia**



Source: MDS, Itaú

**A reassessment of subsidies and programs with low efficiency or weak targeting is also a key component of an adjustment strategy.** Revising *Minha Casa Minha Vida (MCMV)*, which shows evidence of low urban-planning quality, implementation inefficiencies<sup>3</sup>, and a design that tends to select beneficiaries less attached to the labor market—with negative effects on formalization<sup>4</sup>—and for which more efficient alternatives exist in private credit, would eliminate direct subsidies (0.13% of GDP in 2036). The *Pé-de-Meia* program, though well-intentioned in reducing school dropout, is costly, weakly targeted, and overlaps with *Bolsa Família*; reinforcing *Bolsa Família*'s educational conditionalities and technical education would be more effective, generating savings of 0.10% of GDP. The Wage Bonus shows weak targeting<sup>5</sup> relative to its initial objectives of reducing poverty and inequality, given Brazil's high informality (40% of workers); it is a direct transfer without conditions. Its phase-out by 2035<sup>6</sup> would save 0.17% of GDP in 2036.

**Additional initiatives include restrictions on so-called “super salaries” (0.08% of GDP), parliamentary amendments (0.19% of GDP), and agricultural subsidies (0.10% of GDP), as well as a reform of military pensions (0.06% of GDP) and improved benefit-management measures.** Regulating “super salaries” is essential for efficiency and fiscal credibility, requiring correct classification of remuneration versus indemnity payments, enforcement of the constitutional cap, elimination of exceptions, and limits on retroactive payments. The growth of mandatory parliamentary amendments fragments the budget without efficiency gains. The broad coverage of agricultural subsidies is not consistent with the sector's high productivity, international market access, and financing capacity. For the military, correcting rules related to early retirement, full-benefit formulas, and the absence of an effective minimum retirement age would mitigate high costs and asymmetries relative to the general and civil-service regimes. Finally, integrating registries, strengthening medical assessments, standardizing legal rules, and introducing objective criteria for sickness benefits, BPC, and *seguro-defeso* would reduce improper payments without harming legitimate beneficiaries.

<sup>3</sup> Bandeira, L. F., & Reyes Junior, E. (2021). *Minha Casa Minha Vida Program (2012-2016): analysis of the relative efficiency of Brazilian municipalities in the implementation of federal programs.*

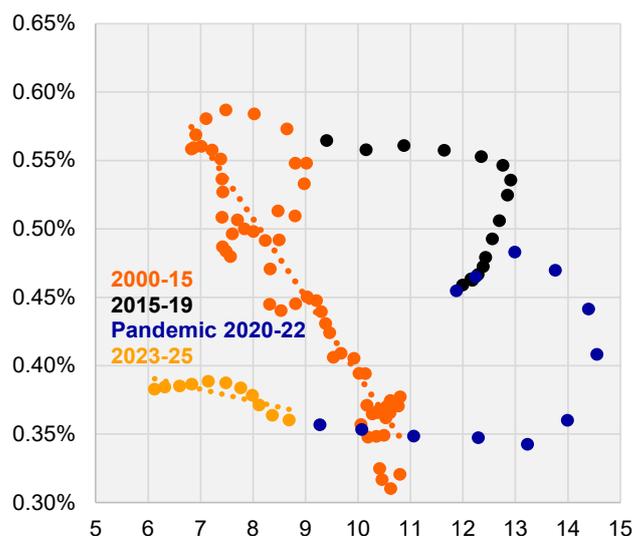
<sup>4</sup> Chagas, A. L. S., & Rocha, G. M. (2019). *Housing program and social conditions impact: Evidences from Minha Casa Minha Vida program lotteries in Brazil.*

<sup>5</sup> Corseuil, C. H. L., Foguel, M. N., & Tomelin, L. F. (2016). *A Evolução recente da abrangência do programa de abono salarial. Ipea.*

<sup>6</sup> At the end of 2024, a convergence was approved so that, by 2035, the benefit's target population will be formal workers earning up to one and a half minimum wages. In an adjustment program, the benefit would be phased out within the same timeframe.

Finally, further savings could come from adjustments to Fundeb (0.16% of GDP), unemployment insurance (0.10% of GDP), and agricultural subsidies (0.10% of GDP). In Fundeb, one could consider reducing the federal complement from 23% to 15% and adjusting the wage floor by inflation. From an efficiency standpoint, it is important to link resources to performance and expand local autonomy, correcting automatic salary-increase mechanisms. For unemployment insurance, the focus would be on the truly vulnerable and on reducing pro-cyclicality, which today stems from rules that favor recurrent use in a high-turnover labor market. A relevant reference is the World Bank’s proposal, which includes declining benefits, stricter rules for repeat claims, and coordination with the FGTS. In agricultural subsidies, despite recent efforts in Proagro, benefits remain high as a share of agricultural GDP and inconsistent with the sector’s productivity and credit access; reducing spending to 0.5% of agricultural GDP would be more consistent with its performance.

**Spending on unemployment insurance is higher the lower the unemployment rate.**

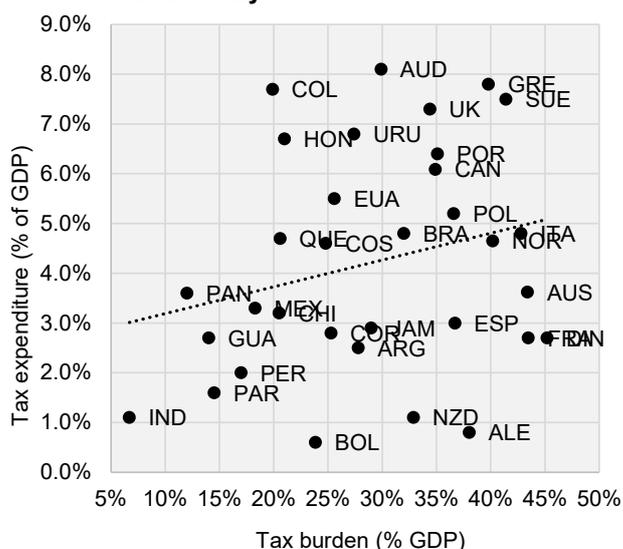


Source: National Treasury, Itaú

**On the revenue side, there is scope to adjust Simples and increase MEI contributions.** One option would be to reduce the Simples threshold, currently R\$4.8 million, to curb its use for tax planning and mitigate disincentives to firm growth, generating 0.16% of GDP in revenue. Aligning MEI contributions with the INSS minimum would eliminate 0.1% of GDP in tax expenditures and increase horizontal equity.

**Regarding tax expenditures, which total about 5% of GDP, there is room for a selective rollback of benefits with lower efficiency and greater political feasibility.** Although sizable, this figure is not an international outlier, even relative to Brazil’s high tax burden. Still, addressing tax expenditures is essential for improving efficiency and reducing distortions and create space for a more sustainable fiscal mix.

**Tax expenditures in Brazil are high, but not an international anomaly.**



Source: Tax Expenditures Lab, Itaú

**A feasible reform could yield around 1.0% of GDP in additional revenue.** The table below classifies existing tax benefits by the perceived difficulty of reversal: a first group, comprising just over half of total expenditures, includes regimes largely defined in the Constitution; a second group includes benefits with direct impact on households, such as IRPF exemptions or benefits to well-organized groups (agribusiness, automotive). An adjustment path would reverse one-third of this second group and the entirety of the remaining group, where restrictions are lower.

Main tax expenditures		
	BRL bln	% of GDP
<b>Total tax expenditure</b>	<b>613</b>	<b>4.6%</b>
<b>Very hard to change</b>	<b>316</b>	<b>2.4%</b>
Simplex and MEI (PEC)	146	1.1%
Basic food basket ("Cesta básica")	45	0.3%
Non profit organizations (PEC)	56	0.4%
Regional Development (PEC)	30	0.2%
"Zona Franca" (PEC)	36	0.3%
PROUNI Education Program	4	0.0%
<b>Remainder</b>	<b>297</b>	<b>2.2%</b>
<b>Hard to change</b>	<b>237</b>	<b>1.8%</b>
IRPF - exempt income (retirement and other)	63	0.5%
IRPF - deductions (health and education)	42	0.3%
Agriculture and Agroindustry	34	0.3%
Labor benefits	24	0.2%
Automobile sector	4	0.0%
Housing	8	0.1%
Payroll tax exemption	13	0.1%
LCI/LCA/CRI/CRA	26	0.2%
<b>PL Income Tax Lower House: medicines/hygiene/thermoelectric</b>	<b>22</b>	<b>0.2%</b>
<b>Other</b>	<b>60</b>	<b>0.5%</b>
"Poupança" and Credit Securities	11	0.1%
Education, events, culture and science	18	0.1%
Information Technology	8	0.1%
Transportation, aircrafts	10	0.1%
Other	13	0.1%

**In addition, there is scope to reduce the burden of state-owned enterprises dependent on the Treasury support.** Their cost reached 0.3% of GDP in 2024, and an agenda of elimination, privatization, or consolidation could save 0.13% of GDP in 2036. Beyond direct fiscal cost, these entities exhibit chronic governance problems, weak financial discipline, high turnover among executives, and overlapping mandates. Dependence on the Treasury weakens efficiency incentives, complicates performance assessment, and perpetuates oversized administrative structures.

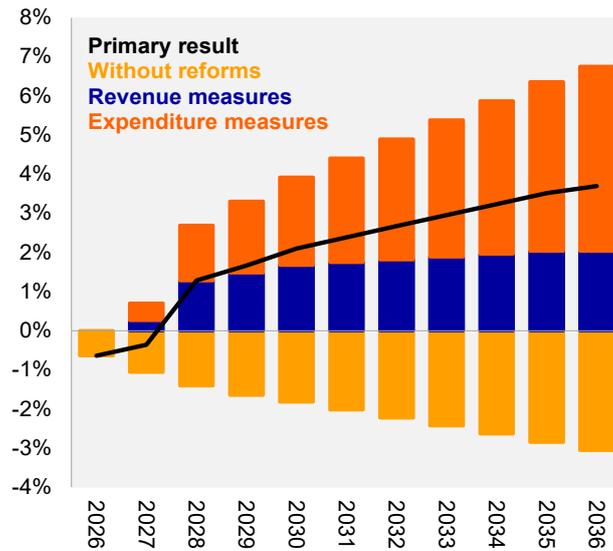
**Finally, additional revenue should come from rising oil-sector receipts and the ongoing reversal of payroll-tax exemptions.** Increasing pre-salt production could deliver approximately 0.5% of GDP in additional revenue by 2030 through royalties, special levies, Petrobras dividends, profit-oil, and corporate taxation. Another source is the reversal of payroll exemptions, which could add around 0.14% of GDP. These revenue gains do not require congressional approval, but it is critical that they are not automatically earmarked for new spending or used to justify future flexibilizations of the fiscal framework.

Measures to implement the fiscal adjustment	Year 2 (2023)	Year 10 (2036)
<b>Total revenues/SOEs + expenditure measures</b>	<b>2.70%</b>	<b>6.76%</b>
<b>Total in expenditure measures</b>	<b>1.42%</b>	<b>4.73%</b>
Expenditures indexed to the minimum wage would be reindexed to the IPCA	0.13%	1.20%
Expenditures indexed to revenues would be reindexed to the IPCA (e.g., health and education)	0.04%	0.40%
Parametric pension reform (min age of 68, rural workers, women, survivors' benefits)	0.11%	1.00%
Old-age BPC: increase eligibility age to 70 and gradually align benefit value with Bolsa Família	0.02%	0.21%
Disability BPC: clarify eligibility criteria and introduce differentiation by severity	0.02%	0.19%
Management measures for sickness benefits, BPC, and Seguro Defeso	0.14%	0.14%
Pension reform for military personnel, police forces, and public security	0.01%	0.06%
Regulation of high public-sector salaries ("supersalaries")	0.08%	0.08%
Cap on parliamentary amendments (maximum of 5% of discretionary spending)	0.19%	0.19%
Lower federal contribution to Fundeb (from 23% to 15%)	0.16%	0.16%
Cap on subsidies to the agricultural sector (return to the hist min as a share of sector GDP)	0.10%	0.10%
End of the Minha Casa Minha Vida (MCMV) program	0.13%	0.13%
End of the Pé-de-Meia program	0.10%	0.10%
End of the wage bonus (Abono Salarial)	0.02%	0.17%
Gradual reduction in Bolsa Família beneficiaries to pre-pandemic levels	0.06%	0.50%
Unemployment insurance reform with integration with FGTS	0.10%	0.10%
<b>Total in revenue and state-owned enterprises measures</b>	<b>1.28%</b>	<b>2.03%</b>
Reduction in the maximum eligibility thresholds for Simples and MEI	0.26%	0.26%
Review of tax expenditures	0.50%	1.00%
Privatization and closure of dependent state-owned enterprises (halving associated costs)	0.13%	0.13%
Confirmation of the reversal of payroll tax exemptions	0.14%	0.14%
New oil revenues	0.25%	0.50%

## 5 – Expected results

**As detailed in the previous section, the measures could bring the primary balance to a surplus of 3.7% of GDP in 2036, with a significant initial impact and a surplus of 1.3% of GDP already in 2028.** We estimate that, in the first two years of implementation, the adjustment would improve the primary balance by 2.7% of GDP—around 40% of the total projected effect. In the initial period, the adjustment is evenly distributed between spending-containment measures and revenue-increasing measures, whereas by 2036 roughly 70% of the adjustment would result from expenditure control. As discussed earlier, expenditure-focused measures tend to generate cumulative gains over time, while revenue measures produce more immediate effects. These results highlight the non-gradual nature of the package, contributing to credibility gains and, consequently, to lower future real interest rates.

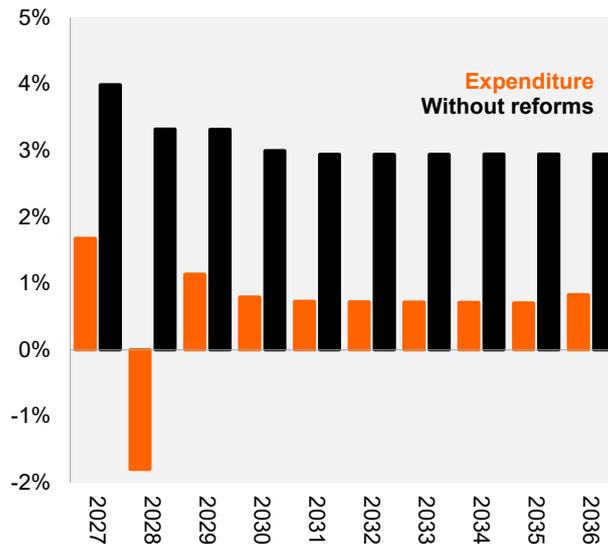
**Primary surplus could reach 3.7% of GDP in 2036**



Source: National Treasury, Itaú

**In terms of expenditure dynamics, the proposed adjustment would imply stable real spending between 2028 and 2030 on average.** The scope for large expenditure containment in 2027 appears limited, given the coexistence with a budget approved in an election year and the need for congressional approval of various measures considered here. For subsequent years, real expenditure growth would remain below 1% per year, helping reduce the required fiscal effort through lower real interest rates.

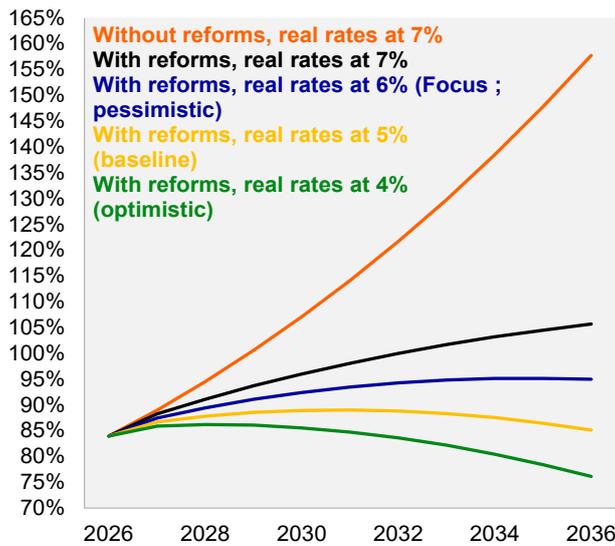
**Real spending growth only slightly positive with reforms**



Source: National Treasury, Itaú

**For the debt trajectory, the difference would be substantial: if implemented, the adjustment implies a debt level at least 60 percentage points of GDP lower in 2036 and stabilization around 85% of GDP in the baseline scenario with real interest rates at 5%.** We emphasize that even under a pessimistic scenario—real interest rates falling only to 6%, as currently projected in the Focus survey—debt would still stabilize, although at a higher level of about 95% of GDP. In an optimistic scenario, in which real interest rates fall to 4%, as observed during the spending-cap years, debt would decline to around 75% of GDP by 2036.

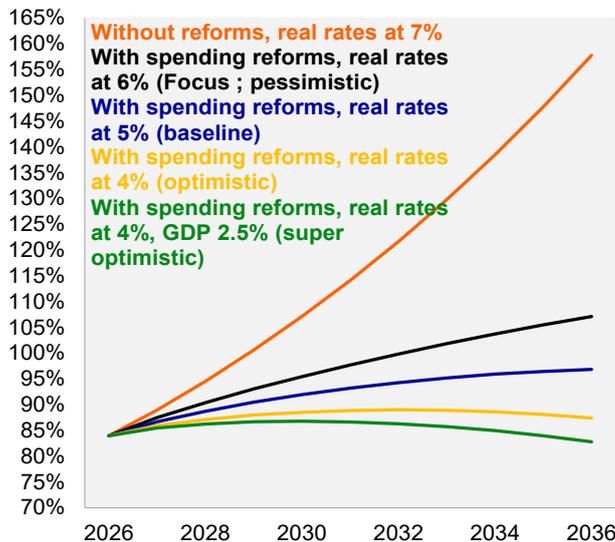
**Debt could be lower than today with proposed reforms**



Source: Brazilian Central Bank, Itaú

Finally, we simulate what the debt trajectory would look like if only expenditure measures were adopted and the revenue path included only the increases associated with oil revenues and the reversal of payroll-tax relief—both of which require no legislative approval. In this scenario, debt would stabilize slightly above 95% of GDP under the baseline assumptions. However, one could argue that the likelihood of a more benign macroeconomic scenario would be higher under an adjustment fully focused on expenditure measures. In such circumstances, the optimistic scenario of 4% real interest rates could be achieved more easily, and economic growth could be higher (e.g., 2.5% instead of 2%). Under this “super-optimistic” scenario, debt would be declining and would stand between 80% and 85% of GDP in 2036. We believe any adjustment becomes more fragile the more it relies on optimistic macroeconomic assumptions.

**Only with spending measures, result rely more on macro assumptions**



Source: Brazilian Central Bank, Itaú

**Conclusion**

In sum, the fiscal adjustment outlined in this report illustrates that it is possible to address the structural imbalance of Brazil’s public finances through a comprehensive set of measures centered on expenditure control and, secondarily, on the reassessment of tax benefits. International experience and empirical evidence consistently show that

expenditure-based consolidations deliver more durable results, are less contractionary, and generate credibility gains that are essential for lowering real interest rates and ensuring public-debt sustainability. The combination of front-loaded measures and deeper structural reforms increases the likelihood of success by signaling commitment and producing visible results early in adjustment process.

The path toward fiscal rebalancing requires discipline, transparency, and a spending rule that is simple and binding, capable of resisting pressures for flexibility and exceptions. Brazil should aim not only to stabilize its debt but to gradually converge toward levels consistent with investment-grade emerging-market peers. Achieving this objective will require a frank and broad dialogue with society, with the goal of laying the foundations for stronger, more sustainable economic growth and reduced vulnerability to external shocks. The challenge is significant, but the diagnosis and measures presented here indicate that there are viable alternatives to restore confidence in fiscal policy and promote a virtuous cycle of development.

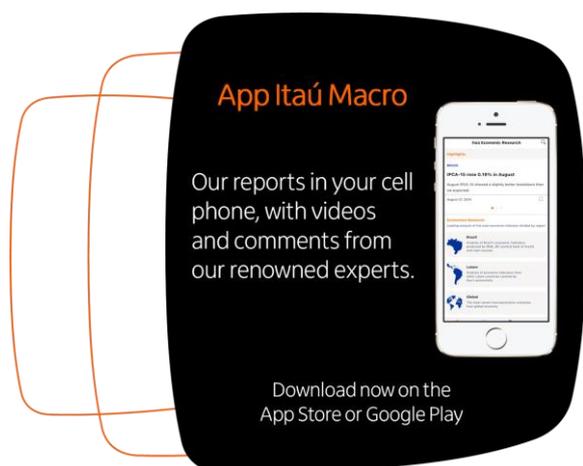
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