Macro scenario - Brazil

May 14, 2024

Changing the flight plan in a context of low visibility

- We maintained our GDP growth forecasts at 2.3% for 2024 and 1.8% for 2025. The latest labor market figures show continuing strength, reinforcing our outlook for historically low unemployment, at 7.8% in 2024 and 8.0% in 2025.
- We maintained our estimates for the primary budget deficit at 0.6% of GDP in 2024 and 0.9% of GDP in 2025. Fiscal risk remains high, given the difficulty in achieving a persistent convergence path in primary results. Resistance to spending control and difficulty to increase revenues imply possible changes in key parameters of the framework approved last year.
- We revised our call for the exchange rate to 5.15 BRL/USD (from 5.00) in 2024 and to 5.25 (from 5.20) in 2025, given the more challenging international scenario (strong dollar globally, with the U.S. economy growing faster than other countries, as well as geopolitical risks) and elevated fiscal risk.
- We revised our forecast for the IPCA consumer price index to 3.8% this year (from 3.7%). Incorporating higher food and industrial goods prices in 2024. Our IPCA call for 2025 increased to 3.7% (from 3.6%) because of the FX effect on industrial goods. For both years, risks are still showing upward asymmetry.
- The challenging global scenario (strong dollar) and domestic uncertainties (pressure on services prices that are more sensitive to the labor market's performance, increased fiscal risk, and unanchored inflation expectations) led the Brazilian Central Bank to revise its flight plan, slowing the pace of monetary easing at its last meeting. Considering the firm commitment stated by the monetary authority to pursuing the inflation target, we assess that the room for additional easing is now more limited and project that the Selic rate will end the year at 10.25% pa, remaining at this level until the end of 2025 (compared to 9.75% in the previous scenario).

Flooding in Rio Grande do Sul: economic impacts

In addition to the terrible humanitarian consequences of the floods in the southern region of the country, we estimate potential impacts on economic activity and inflation. For GDP, the effect could be around -0.3 p.p. of growth in 2024, with potential impacts on the soybean crop and on the industry (with some destruction of installed capacity). For inflation, there may be an upward effect with the supply shock impacting especially rice and soybeans prices, items for which the state is an important producer (this risk is more pronounced for the former than for the latter, as the global supply of soybeans is relatively comfortable now). There could also be temporary pressure on the prices of fresh products.

On the fiscal side, the destruction caused by floods should require necessary extraordinary expenses that are not subject to fiscal rules. In this early stage, it will be important to monitor the scope, duration and values committed in aid to the state.

Resilient growth in the 1st quarter

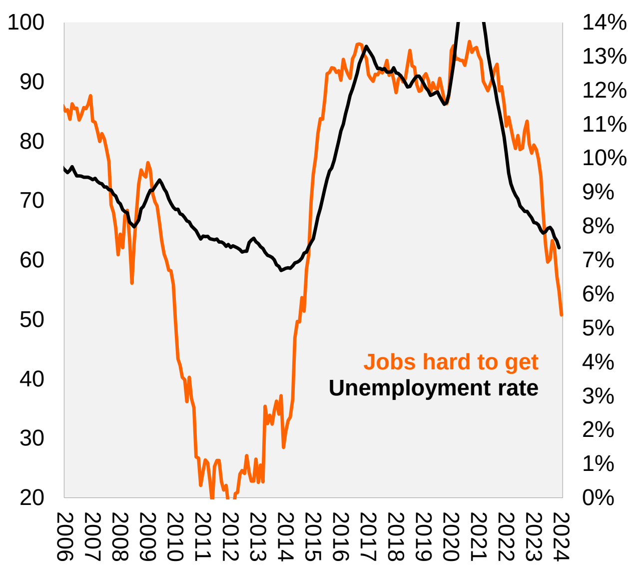
Economic activity remains robust in early 2024. Our GDP tracking points to 0.7% growth at the margin (2.3% yoy) in 1Q24. March figures continued to suggest a strong pace at the beginning of the year. Retail sales (PMC survey) were better than market consensus for the third time this year, with core sales climbing 5.7% yoy vs. an expected 5.2% yoy. Household spending was boosted by the disbursement of court-ordered payments (*precatorios*), adjustments in social benefits linked to the minimum wage, and the anticipated disbursement of the 13th monthly payment for INSS pensioners.

Our 2024 GDP growth estimate remains at 2.3%, driven by firm consumption and by the recovery in investments. April and May should also deliver positive results, with consumer spending benefiting from higher income (given the strength of the labor market, the additional court-ordered payments, the anticipation of regular court-ordered payments to March, and the real increase in the minimum wage). The positive outlook for new loans also helps. On the other hand, the floods in the state of Rio Grande do Sul pose a downward risk to our GDP projection for the year.

For 2025, we continue to see a slowdown in GDP growth to 1.8%. Some of the factors driving activity this year will not be repeated next year. Moreover, the possibility of higher interest rates at the end of the easing cycle means a negative impact on monetary impulse for next year.

The job market remains vigorous (see graph), reinforcing our call for a historically low unemployment rate of 7.8% in 2024. The latest data showed no signs of a cooldown, with gains in both informal and formal employment. Effective real wages for all jobs climbed 1.2% in the quarter. For 2025, we expect a slight increase in the unemployment rate to 8.0% because of the deceleration in GDP.

Falling unemployment and improved perception of the job market



* FGV Consumer Survey: Getting a job today in your city is hard – Getting a job today in your city is easy

Source: IBGE, Itaú

Fiscal risks remain high

We expect a deficit of 0.6% of GDP (BRL 75 billion) in 2024 – still far from the government's zero target and even further from the surplus of at least 1.5% of GDP necessary to stabilize public debt. Current readings continue to surprise positively. Activity remains resilient, additional extraordinary revenue measures restricted to 2024 could take place – such as greater revenues coming from state-owned companies via dividends or reduction in tax disputes – and the tax compensation limit could have recurring effects.

The main risks going forward are related to the difficulty in achieving a persistent trajectory of convergence in primary results, and to possible changes in the main parameters of the framework approved last year. In particular, mandatory spending has grown faster than the government projected and there are limits to the revenue expansion agenda, increasing the risk of early changes to the spending limit in the fiscal framework. If implemented, such changes would bring fresh credibility damage to the government's fiscal plan after the recent change in primary budget targets from 2025 onward.

We continue to expect deterioration next year; our estimate for the primary deficit in 2025 remains at 0.9% of GDP (BRL 110 billion). The worsening picture vs. 2024 reflects lower extraordinary revenues and our assumption that new measures to boost tax revenues will not be approved.

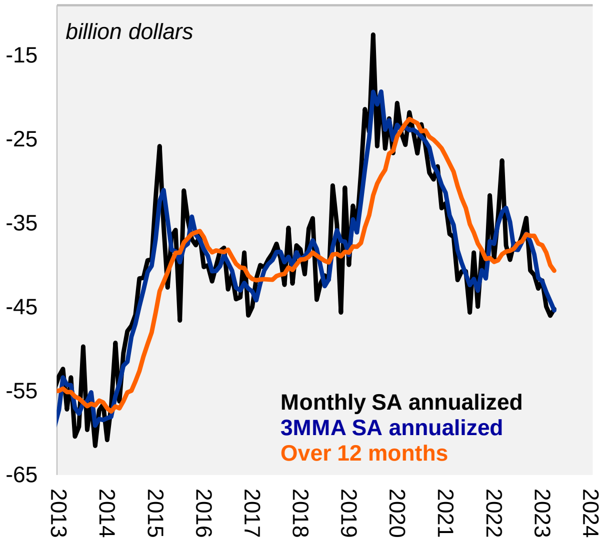
We see gross debt increasing from 74% of GDP in 2023 to 77% of GDP in 2024 and 81% of GDP in 2025.

External and domestic environments continue to exert pressure on the BRL

We revised our call for the exchange rate to 5.15 reais per dollar (from 5.00) in 2024 and to 5.25 (from 5.20) in 2025. The international scenario – with robust growth in the U.S. economy – continues to support a strong dollar, while higher geopolitical pressures are negative for risky assets. Domestically, the trade surplus remains high but has lost momentum, the current account deficit has widened at the margin, and fiscal risk has increased, thus hindering a positive scenario for the BRL.

Our projections for the current account deficit widened significantly because of the worse performance of the services account at the margin. We revised our call for the current account deficit to USD 30 billion in 2024 (from USD 14 billion) and to USD 42 billion in 2025 (from USD 23 billion), incorporating the unfavorable performances of transportation, telecommunications, computer, and information services. The trade surplus continues to lose momentum, as we had anticipated. Our estimates for the trade surplus remain at USD 85 billion in 2024 and USD 70 billion for 2025.

Higher services deficit at the margin exerts pressure on the current account deficit

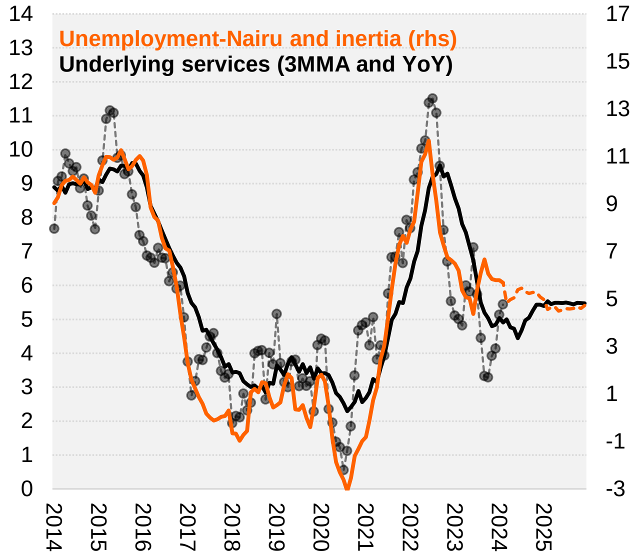


Source: Central Bank, Itaú

Higher inflation forecast for 2024 and 2025

We revised our forecast for the IPCA consumer price index to 3.8% this year (from 3.7%). We incorporated higher food and goods prices in 2024. The balance of risks for our 2024 projection shows upward asymmetry: the tight labor market could push underlying services inflation closer to 6% (vs. 5.5% in our scenario). Furthermore, floods in the south of the country could pressure food inflation even more (mainly via increases in soybean and rice prices). Meanwhile, the increase in Eletrobras's contribution in order to zero the balance of the pandemic and water scarcity accounts is a downside risk for our projection.

Underlying services under pressure from wages and labor market dynamics



Source: Itaú

Our call for 2025 was revised upward to 3.7% (from 3,6%) due to a weaker exchange rate. Importantly, the balance of risks for next year also shows upward asymmetry, considering the tight labor market, persistent services inflation, and a possible extension of the La Niña weather pattern affecting food and energy prices.

Monetary policy: the end is in sight

In an environment of heightened uncertainty, the Copom decided to slow down the monetary easing pace earlier than it had signaled at the March meeting, but broadly in line with market expectations, based on more recent speeches by committee members. The Selic rate fell by 25 bps to 10.50% pa at the meeting held on May 7 and 8.

The external environment has deteriorated significantly in the past few weeks: the notion that the Fed Funds Rate will still take a while to come down (and will not decline that much) has been consolidated, and (secondarily) geopolitical risks have increased.

Domestic conditions got worse too. Fiscal risk increased after the change in primary budget targets from 2025 onward, which postponed and brought more uncertainty to the convergence of public account dynamics. Additionally, the heated labor market continues to exert pressure on labor costs, and inflation expectations for the relevant horizon not only remain unanchored but have increased again.

Against this background and considering the firm commitment stated by the monetary authority to pursuing the inflation target, we assess that the room for additional easing became more limited. Therefore, we expect only more cut in June, to 10.25% pa (previously, we expected further cuts towards 9.75%). In a context of unanchored inflation expectations, we estimate that the Copom will have to maintain the Selic rate at that same contractionary level until the end of 2025 in order to achieve convergence toward the 3.0% target.

Brazil | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	1.2	-3.3	4.8	3.0	2.9	**2.3**	2.3	**1.8**	1.8
Nominal GDP - BRL bn	7,389	7,610	9,012	10,080	10,856	**11,553**	11,533	**12,221**	12,187
Nominal GDP - USD bn	1,872	1,475	1,670	1,951	2,175	**2,269**	2,312	**2,348**	2,386
Population (millions)	210.1	211.8	213.3	214.8	216.3	**217.7**	217.7	**219.0**	219.0
Per Capita GDP - USD	8,910	6,964	7,830	9,084	10,055	**10,424**	10,619	**10,721**	10,892
Nation-wide Unemployment Rate - year avg (*)	12.0	13.8	13.2	9.3	8.0	**7.8**	7.8	**8.0**	8.0
Nation-wide Unemployment Rate - year end (*)	11.7	14.8	11.7	8.4	7.9	**7.8**	7.8	**8.0**	8.0
Inflation									
IPCA - %	4.3	4.5	10.1	5.8	4.6	**3.8**	3.7	**3.7**	3.6
IGP–M - %	7.3	23.1	17.8	5.5	-3.2	**2.6**	1.9	**3.0**	3.0
Interest Rate									
Selic - eop - %	4.50	2.00	9.25	13.75	11.75	**10.25**	9.75	**10.25**	9.75
Balance of Payments									
BRL / USD - eop	4.03	5.19	5.57	5.28	4.86	**5.15**	5.00	**5.25**	5.20
BRL / USD - average	3.95	5.16	5.40	5.17	5.00	**5.09**	4.90	**5.20**	5.00
Trade Balance - USD bn	35	50	61	62	99	**85**	85	**70**	70
Current Account - % GDP	-3.6	-1.9	-2.8	-2.5	-1.3	**-1.3**	-0.6	**-1.8**	-1.0
Direct Investment (liabilities) - % GDP	3.7	3.0	2.8	4.7	2.9	**3.1**	3.0	**3.7**	3.6
International Reserves - USD bn	367	356	362	325	355	**340**	340	**360**	360
Public Finances									
Primary Balance - % GDP	-0.8	-9.2	0.7	1.2	-2.3	**-0.6**	-0.6	**-0.9**	-0.9
Nominal Balance - % GDP	-5.8	-13.3	-4.3	-4.6	-8.9	**-7.0**	-7.0	**-7.2**	-7.2
Gross Public Debt - % GDP	74.4	86.9	77.3	71.7	74.4	**77.2**	77.2	**80.6**	80.6
Net Public Debt - % GDP	54.7	61.4	55.1	56.1	60.9	**64.0**	64.0	**67.3**	67.3

Source: IBGE, FGV, BCB and Itaú

(*) Nation-wide Unemployment Rate measured by PNADC.

(**) We await the release of the complete statistics of the demographic census of 2022 by IBGE. Thus, we have not yet incorporated the estimate of 203.1 million inhabitants in 2022.

Macro Research – Itaú

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