Macro scenario - Brazil

June 13, 2025

No room nor urgency to cut

- We maintained our GDP growth forecasts at 2.2% for 2025 and 1.5% for 2026. However, we made a slight adjustment to the distribution of growth throughout 2025. Recent data point to a weaker performance in the second quarter. On the other hand, the economic impact of court-ordered government payments (*precatórios*) and the expansion of private payroll loans is likely to be more pronounced in the second half of the year. In the labor market, we revised our unemployment rate estimates to reflect the positive surprises seen earlier this year. For 2025, we lowered the unemployment projection from 6.8% to 6.4%, and for 2026, from 7.3% to 6.9%, both below the neutral rate of around 8.0%. That being said, our proprietary labor market indicators show signs of moderation in the May reading.
- The weakening of the dollar against emerging market currencies has contributed to the appreciation of the BRL. Nevertheless, external uncertainties and fiscal risks justify a cautious revision of the exchange rate forecast to BRL 5.65 for both 2025 and 2026 (compared to BRL 5.75 previously). External accounts remain under pressure. Given a weaker-than-expected trade balance, driven by slower deceleration in imports, we now project a current account deficit of 2.6% of GDP in 2025 and 2.4% in 2026 (revised from 2.4% and 2.3%, respectively).
- We revised our IPCA inflation projection for 2025 to 5.3%, reflecting lower inflation in industrial goods – driven by a stronger exchange rate – and in food, particularly due to falling corn prices. The balance of risks for this year remains symmetrical: additional relief from lower food prices (especially proteins) may be offset by upward pressure on electricity costs, given the risk of tariff flags being triggered. For 2026, we maintained our projection at 4.4, as the tight labor market and the continued unanchoring of long-term inflation expectations are set to exert upward pressure.
- We revised our primary result projection for 2025 to -0.6% of GDP (from -0.8%) and maintained the forecast at -0.8% for 2026. The revision incorporates additional revenues from private fund withdraws and the partial impact of the IOF (Tax on Financial Transactions) increase, bringing the 2025 result closer to the target (including legal exceptions). In the remainder of this year, spending is likely to accelerate again, while revenue performance will depend on one-offs and the outcome of the measures currently under discussion.
- The Copom is set to end the monetary tightening cycle in June, keeping the Selic rate at 14.75%, while signaling that it will remain at this level for an extended period. Given that inflation remains above target, expectations are unanchored, and economic activity is resilient, we see no room for rate cuts in 2025. We expect the easing cycle to begin only in 2026, with risks tilted toward a later start – unless there is a significant currency appreciation or an abrupt slowdown in economic activity.

Activity: 2Q started weaker

We maintained our GDP growth forecast at 2.2% for 2025. Although GDP in the first quarter of 2025 came in slightly below expectations, the data continued to indicate resilience in the services sector – which grew 0.3% quarter-over-quarter on a seasonally adjusted basis (compared to 0.2% in Q4 2024) – and in household consumption, which expanded by 1.0%, offsetting the contraction observed at the end of last year.

Despite this, we have adjusted the distribution of growth throughout 2025. Recent data from the IBGE, along with our Daily Activity Indicator (IDAT-Activity), suggest a more moderate short-term economic performance. In light of that, we have revised our GDP growth projection for the second quarter of 2025 (2Q25) to 2.4% year-over-year (0.5% quarter-over-quarter), down from the previous estimate of 2.6% year-over-year (0.6% quarter-over-quarter).

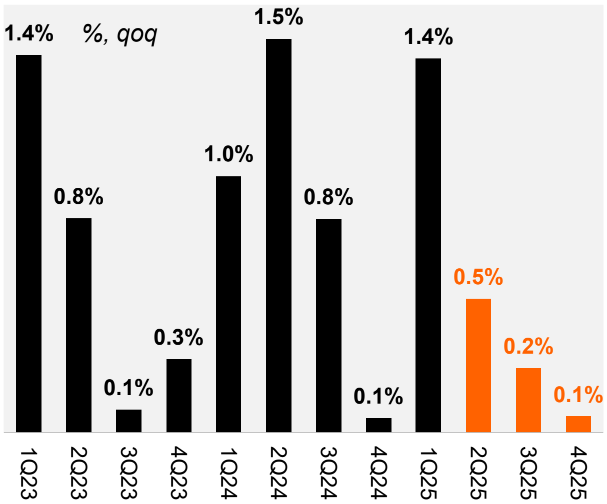
IDAT Heatmap (YoY, nsa)							
Breakdown	Feb-25	Mar-25	Apr-25	May-25	4Q24	1Q25	2Q25
IDAT-Activity	7.5%	2.4%	2.5%	2.8%	4.6%	4.3%	2.7%
IDAT-Services	8.4%	6.6%	3.1%	4.5%	5.7%	6.6%	3.8%
IDAT-Goods	6.5%	-1.7%	1.9%	1.2%	3.6%	2.1%	1.5%
IDAT-Goods sensitive to income	11.1%	5.3%	6.1%	9.5%	7.0%	6.8%	7.9%
IDAT-Goods sensitive to credit	7.3%	-4.7%	-7.1%	-4.4%	7.0%	0.9%	-5.8%

*Considering data up to 31 of may

On the other hand, we have revised upward our GDP projections for the second half of 2025. While our previous expectation pointed to relative stability, we now anticipate growth of 0.2% at the margin. This revision reflects the expected impact of the release of court-ordered payments, scheduled for July, and new payroll loans, both of which should boost economic activity in the second half of the year.

We maintained our growth projection for 2025, but adjusted its distribution throughout the year.

Quarterly GDP



Source: IBGE, Itaú

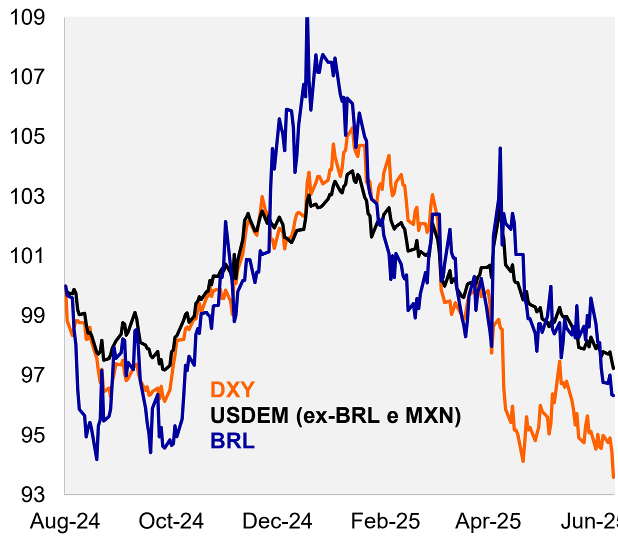
For 2026, we have maintained our growth projection at 1.5%, although the balance of risks remains tilted to the upside. While downside risks from the international environment have eased, the potential implementation of countercyclical fiscal and quasi-fiscal measures remains on the radar. Such initiatives could be adopted to mitigate the slowdown in economic activity next year.

Finally, we revised our unemployment rate estimates downward, reflecting positive short-term surprises. For 2025, the projection was adjusted from 6.8% to 6.4%, while for 2026, it was revised from 7.3% to 6.9%, both below the neutral level (NAIRU) of 8.0%. This revision reflects the most recent data, which indicates a more resilient labor market than initially expected, with the performance of the formal sector making a positive contribution.

Weaker dollar against emerging markets favors BRL

The BRL continues to benefit from the international environment, with the dollar weakening against emerging market currencies. Given the high interest rate differential, the weaker dollar, and a relatively stable risk premium, our models indicate an even stronger appreciation of the BRL than that observed recently. However, considering the high level of uncertainty in the international outlook and domestic risks related to fiscal dynamics – along with external accounts under pressure – we have chosen to adopt a cautious stance. As a result, we are revising our exchange rate projection to BRL 5.65 for both 2025 and 2026, compared to the previous estimate of BRL 5.75.

External Relief Supports Emerging Market Currencies



Source: IBGE, Itaú

On the external accounts front, we have observed a slower-than-expected deceleration of imports, especially those of consumer goods. Given this trend and the worsening terms of trade, we have revised our projection for the trade balance surplus to US$71 billion in 2025 (down from US$76 billion) and US$74 billion in 2026 (down from US$77 billion). For the current account, we now project deficits of 2.6% of GDP in 2025 (compared to 2.4%) and 2.4% in 2026 (compared to 2.3%). Although foreign direct investment (excluding reinvested earnings) has improved marginally, it remains insufficient to fully cover the current account deficit, limiting the sustainability of a significantly stronger exchange rate.

Inflation: relief in 2025, but upward risks persist for 2026

We have reduced our projection for the IPCA in 2025 from 5.5% to 5.3%. This reflects two main factors: the appreciation of the exchange rate, which tends to ease the prices of industrial goods, and the recent drop in corn prices, which impacts food costs. For 2025, we assess that the risks to inflation are relatively balanced. On one hand, a slower reversal in the beef cycle may keep protein prices at lower levels. On the other hand, reduced rainfall increases the likelihood of triggering the yellow or red electricity tariff flags at the end of the year, putting upward pressure on energy costs.

For 2026, we have maintained our inflation projection at 4.4%. The balance of risks is asymmetric to the upside, with the labor market still under pressure and the persistence of unanchored inflation expectations over the longer term representing the main upward risks.

Public accounts: closer to meeting target

We revised our primary balance projection to -0.6% of GDP in 2025 (from -0.8%) and maintained it at -0.8% for 2026. For 2025, we incorporated one-offs revenues associated with the withdrawal of private funds, and the partial effect of the announced IOF increase. Thus, we see the government closer to meeting the lower limit of the -0.6% of GDP target (considering legal exceptions and -0.25% lower limit of the official 0% target). Note that the surplus level necessary to stabilize the debt is around 2.5% of GDP. For 2026, the main risk is the implementation of initiatives that explicitly or implicitly change, circumvent, or distort fiscal rules, resulting in higher growth rates in primary expenditures and/or greater revenue waivers.

Over the year, spending is poised to accelerate again, while revenue performance will depend on extraordinary revenues and the impact of recently announced measures. Since the beginning of the year, we have seen a slowdown in both expenses and revenues. However, the slowdown in expenses may be temporary due to factors such as the anticipated normalization of the INSS waiting list, increased budget execution following its approval, retroactive payments of civil servants' salary adjustments, and the postponement of court order payments. In contrast, revenue performance will depend on one-offs (such as oil auctions and dividends from state-owned companies) and the implementation and effects of recently announced measures as alternatives to the increase in the IOF, amid the slowdown in economic activity.

Looking ahead, structural measures to address the rigidity and rapid growth of mandatory spending would enhance the credibility of the fiscal adjustment necessary for public debt sustainability.

Monetary policy: contractionary stance for a prolonged period

Copom will meet again on June 17 and 18, when it is likely to end the current cycle of monetary tightening by unanimously deciding to maintain the Selic rate at the current level of 14.75% pa.

In the recent official communication, following the May meeting, we understood that the Central Bank appears confident that monetary policy is at a significantly contractionary level and that economic activity is decelerating, albeit with mixed signals. Additionally, the authorities seemed to indicate a preference for maintaining high interest rates over a prolonged period. Since then, we have not observed significant changes in the background conditions for the monetary policy decision. The international environment remains volatile and highly uncertain. Domestic activity remains resilient but shows ambiguous signals, indicating some moderation. Current inflation is above the target, and expectations remain above target, but in both cases without further deterioration.

Therefore, the authorities will likely opt to maintain the Selic rate stable, signaling that the interest rate will remain at the current level for as long as necessary, and that they will not hesitate to resume the tightening cycle if there are changes in the prospective inflation scenario.

We do not see room for interest rate cuts this year, given unanchored expectations and still-resilient activity. We project the easing cycle to begin only in early 2026, with the Selic rate declining to 12.75%. We do not expect any rate cuts before then, unless there is a significant appreciation of the currency (to around BRL 5.00/US$) or an abrupt slowdown in economic activity. If anything, the greater risk is that the start of the easing cycle could be postponed until the second quarter of 2026.

Brazil | Forecasts and Data

	2020	2021	2022	2023	2024	2025F		2026F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-3.3	4.8	3.0	3.2	3.4	**2.2**	2.2	**1.5**	1.5
Nominal GDP - BRL bn	7,610	9,012	10,080	10,943	11,745	**12,650**	12,650	**13,432**	13,438
Nominal GDP - USD bn	1,475	1,670	1,951	2,192	2,179	**2,213**	2,196	**2,377**	2,337
Population (millions)	209.2	210.1	210.9	211.7	212.6	**213.4**	213.4	**214.2**	214.2
Per Capita GDP - USD	7,050	7,949	9,255	10,356	10,251	**10,368**	10,289	**11,098**	10,910
Nation-wide Unemployment Rate - year avg, NSA	13.5	13.5	9.5	8.0	6.9	**6.3**	6.6	**6.8**	7.1
Nation-wide Unemployment Rate - year end (*)	14.7	11.6	8.4	7.9	6.6	**6.4**	6.8	**6.9**	7.3
Inflation									
IPCA - %	4.5	10.1	5.8	4.6	4.8	**5.3**	5.5	**4.4**	4.4
IGP–M - %	23.1	17.8	5.5	-3.2	6.5	**3.8**	4.7	**4.0**	4.3
Interest Rate									
Selic - eop - %	2.00	9.25	13.75	11.75	12.25	**14.75**	14.75	**12.75**	12.75
Balance of Payments									
BRL / USD - eop	5.19	5.57	5.28	4.86	6.18	**5.65**	5.75	**5.65**	5.75
BRL / USD - average	5.16	5.40	5.17	4.99	5.39	**5.72**	5.74	**5.65**	5.75
Trade Balance - USD bn	50	61	62	99	75	**71**	76	**74**	77
Current Account - % GDP	-1.7	-2.4	-2.2	-1.3	-2.8	**-2.6**	-2.4	**-2.4**	-2.3
Direct Investment (liabilities) - % GDP	3.0	2.8	4.7	2.8	3.2	**3.8**	3.9	**3.9**	3.9
International Reserves - USD bn	356	362	325	355	330	**330**	330	**330**	330
Public Finances									
Primary Balance - % GDP	-9.2	0.7	1.2	-2.3	-0.4	**-0.6**	-0.8	**-0.8**	-0.8
Nominal Balance - % GDP	-13.3	-4.3	-4.6	-8.8	-8.5	**-8.8**	-8.9	**-9.2**	-9.3
Gross Public Debt - % GDP	86.9	77.3	71.7	73.8	76.5	**79.4**	79.6	**84.0**	84.2
Net Public Debt - % GDP	61.4	55.1	56.1	60.4	61.5	**66.9**	66.8	**72.2**	72.2
Growth of public spending (% real, pa, **)	29.2	-24.7	6.0	7.6	3.2	**3.1**	2.9	**2.4**	2.7

Source: IBGE, FGV, BCB and Itaú
(*) Nation-wide Unemployment Rate measured by PNADC.

(**) We do not consider the 2023 payment of extraordinary court-ordered debts (precatórios). Including it, spending grew by 12.5% in 2023 and fell by 0.9% in 2024.

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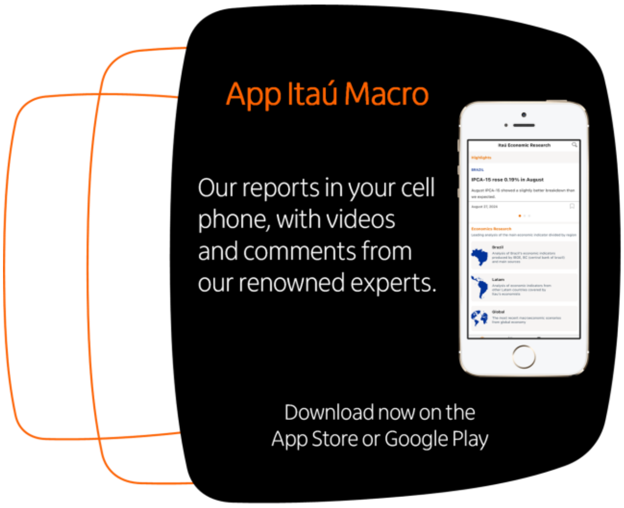

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