# Macro scenario - Brazil

March 17, 2025

## Some relief amid still-high uncertainty

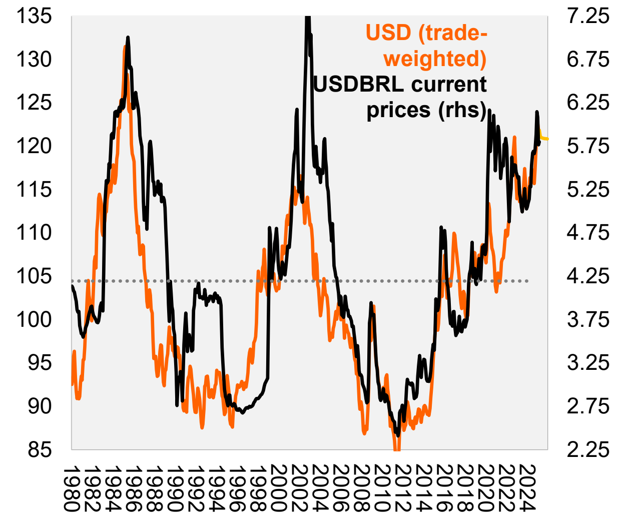
- Given the easing of the international environment and the expectation of a global weakening of the dollar, we have revised our exchange rate projections for 2025 and 2026 to BRL 5.75 per dollar (from BRL 5.90).
- The fiscal challenge, however, remains significant. We expect primary deficits of 0.7% of GDP in both 2025 and 2026. We believe that the announcement of a significant containment of discretionary expenses of roughly BRL 35 billion and the inclusion of extrabudgetary expenses within the limits of the fiscal rules would at least mitigate the risk of loss of credibility in the framework as a fiscal anchor; such a credibility loss could lead to a further worsening in the perception of fiscal risk.
- Our GDP growth estimates for 2025 and 2026 remain unchanged at 2.2% and 1.5%, respectively. Despite the weaker GDP result in 4Q24, data indicate that the economy performed better in January and February, in line with our expectation of a gradual slowdown throughout the year. For the labor market, we still forecast the unemployment rate ending this year at 6.8% and then rising to 7.3% in 2026.
- We have revised our inflation projection for 2025 to 5.7% (from 5.8%) and maintained our 2026 projection at 4.5%. For the first time since September 2024, we do not see an asymmetric balance of risks to the upside for this year; on the contrary, the downside risks – due to the effect of the stronger currency on industrial, food, and gasoline prices – outweigh the upside risks.
- With expectations unanchored and the output gap in positive territory, the Central Bank will need to continue moving into contractionary territory. However, the stronger currency and some downside risks for inflation will likely prompt the monetary policy authority to end the interest rate hiking cycle at a lower level than we previously expected. We now project the Selic rate reaching 15.25% per year (previously 15.75%) by the end of the first half of this year.

### BRL: Some relief from the international environment

**After reaching BRL 6.30 per dollar at the end of 2024, the Brazilian real regained strength in the first months of this year.** This appreciation was driven by an increase in the interest rate differential and, primarily, by relief in the international scenario. On the external front, the trend of global dollar strengthening lost momentum amid new fiscal stimulus in the eurozone and the uncertainties generated by Trump's aggressive stance on tariffs, which could negatively affect U.S. economic growth.

**We have revised our exchange rate projection to BRL 5.75 per dollar at the end of both this year and next (previously BRL 5.90 per dollar).** On the one hand, the widening interest rate differential and the expectation of a weaker dollar are contributing to a more appreciated exchange rate. On the other hand, this appreciation is likely to be limited by the high Brazilian risk premium due to fiscal uncertainties and the deterioration recently seen in the external accounts.

**Weaker USD is contributing to a more appreciated exchange rate**




Source: BBG, Itaú

## Taxes: No signs of a route adjustment

**We expect primary deficits of 0.7% of GDP in both 2025 and 2026.** For 2025, for now, we do not expect the target of -0.6% of GDP to be met (considering accounting exceptions and the 0% lower limit of the official target range), although we recognize that there is a risk of a better result than what we are currently estimating, given the government's continuing efforts on its revenue agenda. For 2026, the main risk lies in the implementation of initiatives that explicitly or implicitly alter, circumvent, or distort fiscal rules, resulting in higher rates of growth in primary expenditure and/or more revenue foregone.

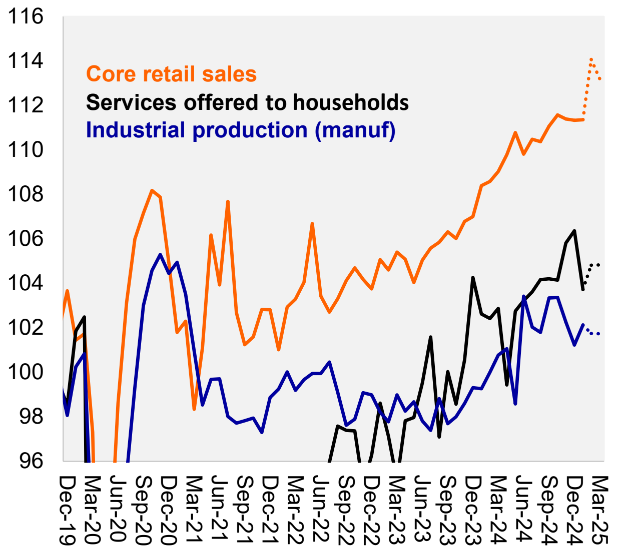
**In terms of expenditures, we believe that it will be important for the government to announce a significant cut in discretionary spending, on the order of BRL 35 billion, as a way of reinforcing its commitment to its fiscal plan.** The announcement of a robust expenditure cut in the first bimonthly review in March would signal greater prudence in budget execution in light of the risk of disappointing extraordinary revenues and the potential for a further underestimation of mandatory expenses (as occurred in 2024, mainly with Social Security and BPC). In addition to this initiative, including extrabudgetary expenses within the limits of the fiscal rules would at least mitigate the risk of a loss of credibility in the framework as a fiscal anchor; such a credibility lost could lead to a further worsening in the perception of fiscal risk.

## Activity: we expect a pick-up in 1Q25

**We have left our GDP growth estimate for 2025 unchanged at 2.2%.** Despite the weaker GDP data for 4Q24, particularly regarding household consumption, we expect the economy to accelerate in the first three months of the year, driven mainly by strong performance in the agricultural sector and the adjustment of the minimum wage.

**We project year-over-year growth of 3.1% in 1Q25.** The January data released by IBGE, along with the February figures from our daily activity indicator (IDAT-Activity), suggest that the economy has accelerated again on a margin basis in the first months of the year.

**Resilient activity in 1Q25**




Source: IBGE, Itaú

**The economic slowdown is likely to be gradual and will probably become more apparent in the second half of the year**. The slowdown in fiscal impulse (via transfers) and the intensification of the lagging effects of contractionary monetary policy will likely put pressure on activity in the second half. As a result, we expect GDP to remain relatively stable over this period.

**For 2026 we have also left our growth projection unchanged, at 1.5%.** We assume that the intensification of the lagging effects of interest rate hikes will not be offset by countercyclical fiscal and parafiscal policies.

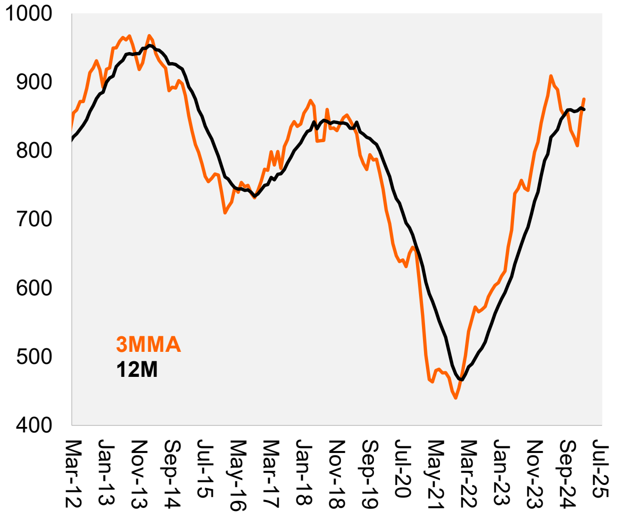
**Finally, we have maintained our unemployment rate projections for 2025 and 2026 at 6.8% and 7.3%, respectively.** The data from January showed continued resilience in the labor market, especially in the formal sector.

## Inflation: a small downward revision and asymmetric downside risks in 2025

**We have revised our inflation projection for 2025 from 5.8% to 5.7%, reflecting developments in the pricing dynamics for household foods, particularly proteins.** The high level of cow slaughter suggests a slowdown at the turn of the cattle cycle, while the appreciation of the currency also affects prices. It is important to note that we did not incorporate the full pass-through of the stronger currency. In the context of an open gap and unanchored expectations, the full pass-through of the depreciation in 2024 would be expected, but it has not yet materialized.

For the first time since September 2024, we do not see an asymmetric balance of risks to the upside; on the contrary, the downside risks – due to the effects of the stronger currency on the prices of industrial products, food, and gasoline – outweigh the upside risks.

**Level of slaughter of cows suggests a slower turnaround in the cattle cycle**




Source: Itaú

Source: BCB, Itaú

**For 2026, we are leaving our inflation projection unchanged at 4.5%.** The main upside risk in this horizon remains the potential for a further unanchoring of long-term expectations.

## Monetary policy: contractionary, but a smaller cycle

**The interest rate cycle will likely continue to move into contractionary territory, but it could be shorter.** As highlighted by the committee in its latest meeting minutes, the pace of economic activity, the dynamics of the exchange rate and exchange rate pass-through, as well as inflation expectations, will all be crucial in determining the length of the cycle. We continue to assess that unanchored inflation expectations, the positive gap, and the Central Bank's projections are consistent with a continuation of the monetary tightening cycle through the first half of this year. However, we also understand that given the accommodation of the exchange rate at more appreciated levels, the Central Bank is likely to opt for a slightly shorter cycle.

**We have revised our projection for the end of the cycle to 15.25% per year at the June meeting, with this level likely being maintained until the end of the year (previously 15.75%).** We expect a 100-bp increase in March (as has already been signaled by the committee), followed by two final 50-bp increases in May and June.

**For 2026, we project interest rate cuts throughout the first half of the year bringing the rate down to 13.25% per year.**

## 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 | **12,698** | 12,800 | **13,503** | 13,660 |
| Nominal GDP - USD bn | 1,475 | 1,670 | 1,951 | 2,192 | 2,179 | **2,197** | 2,181 | **2,348** | 2,315 |
| 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 | **10,295** | 10,221 | **10,962** | 10,808 |
| Nation-wide Unemployment Rate - year avg, NSA | 13.8 | 13.2 | 9.3 | 8.0 | 6.8 | **6.6** | 6.6 | **7.1** | 7.1 |
| Nation-wide Unemployment Rate - year end (*) | 14.7 | 11.6 | 8.4 | 7.9 | 6.6 | **6.8** | 6.8 | **7.3** | 7.3 |
| **Inflation** | | | | | | | | | |
| IPCA - % | 4.5 | 10.1 | 5.8 | 4.6 | 4.8 | **5.7** | 5.8 | **4.5** | 4.5 |
| IGP–M - % | 23.1 | 17.8 | 5.5 | -3.2 | 6.5 | **5.9** | 6.3 | **4.3** | 4.3 |
| **Interest Rate** | | | | | | | | | |
| Selic - eop - % | 2.00 | 9.25 | 13.75 | 11.75 | 12.25 | **15.25** | 15.75 | **13.25** | 13.75 |
| **Balance of Payments** | | | | | | | | | |
| BRL / USD - eop | 5.19 | 5.57 | 5.28 | 4.86 | 6.18 | **5.75** | 5.90 | **5.75** | 5.90 |
| BRL / USD - average | 5.16 | 5.40 | 5.17 | 5.00 | 5.39 | **5.78** | 5.85 | **5.75** | 5.90 |
| Trade Balance - USD bn | 50 | 61 | 62 | 99 | 75 | **79** | 76 | **80** | 80 |
| Current Account - % GDP | -1.7 | -2.4 | -2.2 | -1.3 | -2.8 | **-2.2** | -2.1 | **-2.2** | -1.9 |
| Direct Investment (liabilities) - % GDP | 3.0 | 2.8 | 4.7 | 2.8 | 3.2 | **3.9** | 3.9 | **3.9** | 4.0 |
| 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 | **-0.7** | -0.7 | **-0.7** | -0.7 |
| Nominal Balance - % GDP | -13.3 | -4.3 | -4.6 | -8.8 | -8.5 | **-9.2** | -9.2 | **-9.8** | -9.9 |
| Gross Public Debt - % GDP | 86.9 | 77.3 | 71.7 | 73.8 | 76.5 | **79.6** | 79.4 | **84.7** | 84.3 |
| Net Public Debt - % GDP | 61.4 | 55.1 | 56.1 | 60.4 | 61.5 | **66.9** | 67.0 | **72.7** | 72.7 |
| Growth of public spending (% real, pa, **) | 29.2 | -24.7 | 6.0 | 7.6 | 3.2 | **2.9** | 2.6 | **2.8** | 2.8 |

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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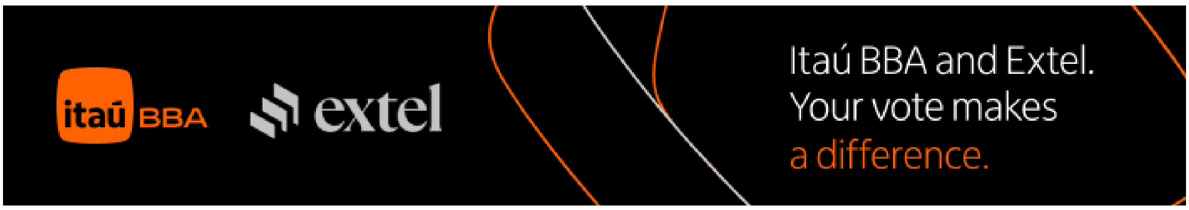

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