Macro scenario - Brazil

May 16, 2025

The end of the tightening cycle, but still with no cuts

- We maintain our GDP growth forecasts at 2.2% for 2025 and 1.5% for 2026. The slowdown in economic activity is set to become more evident in the second half of the year, after strong performance at the beginning of 2025 driven by the agricultural sector and income-driven consumption. Regarding the labor market, we maintained our unemployment rate projection at 6.8% in 2025 and 7.3% in 2026.
- The international environment is being the main driver for the currency. On the one hand, progress in tariff negotiations between the U.S. and China reduces the likelihood of a more intense slowdown worldwide and increases the attractiveness of risk assets. On the other hand, reduced trade tensions between the United States and other countries increase the chance of keeping the American exceptionalism in place, resulting in a stronger dollar globally. For now, we maintain our exchange rate projection at BRL 5.75 per dollar in 2025 and 2026.
- We also maintained our forecast for the IPCA at 5.5% in 2025 and 4.4% in 2026. The balance of risks for this year is symmetrical. A potential decrease in trade flows between China and the United States and the lower price of metal commodities could result in a more benign industrial items inflation. However, reduced rainfall increases the probability of triggering higher-cost energy tariff flags at the end of the year.
- Significant fiscal challenges persist. We maintained our primary result estimate of -0.8% in 2025 and 2026, but we believe it is important for the government to announce spending control measures in the next bimonthly report.
- In its recent communication, the Central Bank appears to have gained confidence that monetary policy is at a significantly contractionary level and that economic activity is slowing down. In addition, the authorities have apparently opted for a high-for-long strategy. We now expect the Selic rate to remain stable at 14.75% pa until the end of the year. We see cuts only next year (to 12.75%).

Economic activity: robust 1Q growth

We maintained our GDP growth estimate for 2025 at 2.2%. After strong growth at the beginning of the year, the slowdown in economic activity is set to be more pronounced in 2H25 due to a global loss of momentum and the delayed effects of monetary tightening.

Our 1Q25 tracking points to a 1.8% qoq/sa growth (3.3% yoy), which is above our current estimate of 1.6% (3.1% yoy). March data indicated that the economy ended the quarter at a robust pace, driven by the agricultural sector and sustained household income. As a result, demand for income-sensitive items remains more dynamic than that for items more heavily dependent on credit.

On the other hand, April data point to a sharper slowdown. Our Daily Activity Indicator (IDAT-Activity) recorded a sharper decline in the services sector and sales of credit-sensitive goods, while income-sensitive goods showed some resilience (see table at the end). The positive performance in March, combined with the holidays in April, which were extended holidays in the case of Rio de Janeiro, may have influenced the month's results. Therefore, monitoring economic activity data in May is crucial to calibrate our GDP projections in the 2Q25.

For 2026, we maintained our GDP growth estimate at 1.5%. In this horizon, the balance of risks appears to be mostly upside. Although the international scenario still presents challenging prospects, possible countercyclical fiscal and parafiscal policies may more than offset the external vector, acting as impulse for economic activity next year.

Finally, we maintained our estimates for the labor market, with unemployment rates projected at 6.8% for 2025 and 7.3% for 2026. Despite the observed volatility, data continue to indicate a booming labor market.

BRL: the international scenario remains the main driver

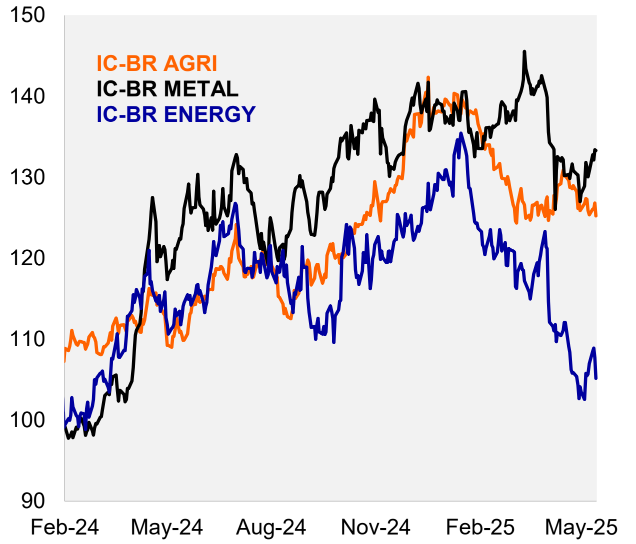
The FX rate is still being mainly driven by external factors. After reaching BRL 6.00/USD immediately after the announcement of the new U.S. tariffs, the Brazilian currency has been gaining strength against the dollar – in the wake of a weaker dollar globally – reaching highs close to 5.60.

For now, we have maintained our exchange rate projection at BRL 5.75 per dollar for 2025 and 2026. Progress in tariff negotiations in G2 reduces the likelihood of a more intense slowdown worldwide, tending to increase the attractiveness of risk assets. This, combined with the high interest rate differential, favors Brazilian currency appreciation to levels slightly below BRL 5.50. However, a trade agreement between the U.S. and other countries, especially China, increases the chance of keeping the so-called American exceptionalism in place. This, combined with domestic fiscal uncertainties and an unfavorable dynamic involving external accounts, limits more positive scenarios for the currency.

Inflation: forecasts maintained, and symmetrical balance of risks

We maintained our projection for the 2025 IPCA at 5.5%. We assess that the downside and upside risks for inflation are balanced in 2025. On the one hand, a potential decrease in trade flows between China and the United States and the lower prices of metal commodities could result in a more benign industrial inflation rate. On the other hand, reduced rainfall increases the probability of activating yellow and red flag electricity rates at the end of the year.

Commodity prices currently lower than pre-tariff levels. Reduced trade tensions limit the odds of further declines



Source: Itaú

For 2026, we maintained our inflation estimate at 4.4%. The balance of risks is asymmetrical, with the labor market still under pressure and persistent unanchored inflation expectations in the long term being the main upside risks.

Fiscal: stricter control over expenses is still very necessary

We maintained our primary result projection at -0.8% of GDP in 2025 and 2026. For 2025, for now, we do not expect the target of -0.6% of GDP (considering exclusions and the lower limit of the official target of 0%) to be met. This will depend on how successful the government's revenue agenda will be, especially extraordinary revenues such as oil auctions and dividends from state-owned companies. For 2026, the main risk is the implementation of initiatives that explicitly or implicitly change, circumvent, or distort fiscal rules, implementing higher growth rates for primary expenditures and/or greater revenue waivers – which, by the way, has been a typical combination in general election years.

We believe it is crucial for the government to announce spending control measures. A substantial budget cut – around BRL 40 billion – in the upcoming bimonthly review on May 22 would signal greater prudence in budget execution, given the risks of disappointing extraordinary revenues and a renewed underestimation of mandatory expenses (as was the case in 2024, particularly with Social Security and the BPC, where anti-fraud initiatives have shown little evidence of success). However, the signs point to a smaller and more gradual adjustment, without completely resolving the issue of off-budget spending, which then contributes to sustaining the high level of fiscal risk.

Monetary policy: end of cycle, but still with no cuts

In its most recent decision, the Copom delivered the expected increase of 50 bps, raising the Selic rate to 14.75% per year, without giving any information about the next meeting. Inflation projections remain above the target over the relevant horizon (3.6% in 4Q26), which likely motivated this decision. In our view, assessment by authorities of the potential effects of a change in the external environment (by adopting a perspective that the balance of risks for the central scenario is symmetrical) has set a relatively high bar for a new adjustment of the Selic rate in June.

We now expect the Selic rate to remain stable at 14.75% per year until the end of the year. In its recent communication, the Central Bank appears to have gained confidence that the monetary policy is at a significantly contractionary level and that economic activity is slowing down, with signs of a cooling labor market and a change in some credit lines. In addition, the authorities seem to have opted for a high-for-long strategy. According to our simulations, a Selic rate stable at 14.75% would produce an inflation projection in the relevant horizon (4Q26) of around 3.3% - probably close enough to the target for the committee.

We do not see room for interest rate cuts this year due to unanchored expectations and resilient economic activity. We project cuts only throughout 2026, when the interest rate will reach the 12.75% level.

IDAT Heatmap (YoY, nsa)

Breakdown	Oct-24	Nov-24	Dec-24	Jan-25	Feb-25	Mar-25	Apr-25	3Q24	4Q24	1Q25
IDAT-Activity	6.5%	6.5%	1.4%	3.7%	7.3%	2.3%	2.4%	6.4%	4.6%	4.2%
IDAT-Services	6.1%	9.0%	2.2%	4.8%	8.3%	6.5%	3.1%	6.7%	5.7%	6.5%
IDAT-Goods	6.8%	3.8%	0.5%	2.3%	5.7%	-2.7%	1.7%	6.2%	3.6%	2.0%
IDAT-Goods sensitive to income	7.3%	6.5%	2.5%	4.5%	10.2%	4.3%	5.1%	4.3%	5.2%	5.2%
IDAT-Goods sensitive to credit	12.5%	3.9%	2.6%	2.6%	7.3%	-4.6%	-7.3%	9.1%	6.3%	1.0%

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**	12,642	**13,438**	13,441
Nominal GDP - USD bn	1,475	1,670	1,951	2,192	2,179	**2,196**	2,188	**2,337**	2,338
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	**10,289**	10,250	**10,910**	10,913
Nation-wide Unemployment Rate - year avg, NSA	13.5	13.5	9.5	8.0	6.9	**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	**5.5**	5.5	**4.4**	4.4
IGP–M - %	23.1	17.8	5.5	-3.2	6.5	**4.7**	4.8	**4.3**	4.3
Interest Rate									
Selic - eop - %	2.00	9.25	13.75	11.75	12.25	**14.75**	15.25	**12.75**	13.25
Balance of Payments									
BRL / USD - eop	5.19	5.57	5.28	4.86	6.18	**5.75**	5.75	**5.75**	5.75
BRL / USD - average	5.16	5.40	5.17	4.99	5.39	**5.76**	5.77	**5.75**	5.75
Trade Balance - USD bn	50	61	62	99	75	**76**	76	**77**	77
Current Account - % GDP	-1.7	-2.4	-2.2	-1.3	-2.8	**-2.4**	-2.4	**-2.3**	-2.3
Direct Investment (liabilities) - % GDP	3.0	2.8	4.7	2.8	3.2	**3.9**	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	**-0.8**	-0.8	**-0.8**	-0.8
Nominal Balance - % GDP	-13.3	-4.3	-4.6	-8.8	-8.5	**-8.9**	-9.0	**-9.3**	-9.5
Gross Public Debt - % GDP	86.9	77.3	71.7	73.8	76.5	**79.6**	79.8	**84.2**	84.5
Net Public Debt - % GDP	61.4	55.1	56.1	60.4	61.5	**66.8**	67.0	**72.2**	72.4
Growth of public spending (% real, pa, **)	29.2	-24.7	6.0	7.6	3.2	**2.9**	3.0	**2.7**	2.6

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.

Macro Research – Itaú

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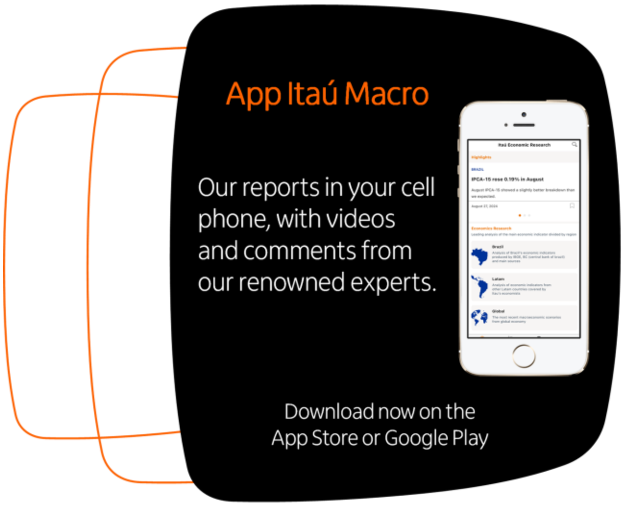

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