Macro Research

Monthly Scenario Review | BRAZIL
10 themes for 2026

BRAZIL: 10 themes for 2026

Activity: moderate deceleration

1. Increasing our GDP growth forecast for 2026 to 1.9% from 1.7%; our call for 2027 is 1.7%. What factors are driving growth, and is there any bias?
2. What explains the recent labor market dynamics? What is the outlook for 2026?

BRL: limited room for sustained appreciation

3. Benign external environment versus domestic uncertainty: which factor will drive FX dynamics throughout the year?
4. The deterioration of external accounts constrained the BRL appreciation in 2025. What should we expect for 2026?

Inflation: IPCA within the tolerance range

5. What should we expect for 2026 and 2027? What are the main risks?
6. Could downside risks in tradable goods bring inflation closer to the target?

Monetary policy: approaching the beginning of an easing cycle

7. When will it start, and how large will it be?

Public accounts: stimulus amid electoral uncertainty

8. Additional demand-side stimulus remains the main fiscal risk in 2026

Elections and the challenges for the next administration

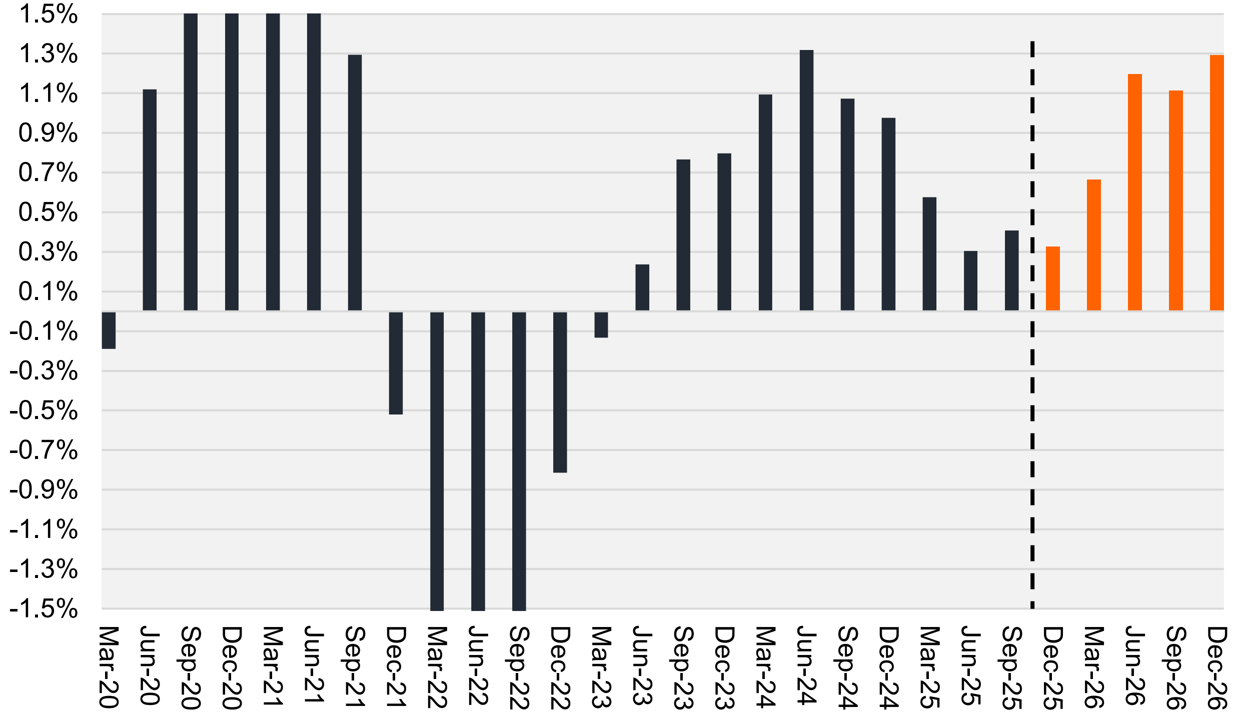
9. Elections: the race is likely to be narrow. Will the elected government signal a fiscal adjustment in the next mandate?
10. Fiscal adjustment: what is the size of the required adjustment?

Activity: moderate deceleration

1. 2026 GDP at 1.9%. What factors are driving growth, and is there any bias?

- **We revised our GDP growth forecast to 1.9% (from 1.7%), incorporating the upward revision to global economic activity.**
  - In addition to the global environment, fiscal and quasi-fiscal impulses are also contributing to growth this year and are set to increase to 1.1 p.p. (from 0.4 p.p. in 2025): 0.3 p.p. from BNDES, 0.3 p.p. from income tax exemptions, 0.1 p.p. from E&M, and 0.4 p.p. from federal spending.
- The bias remains tilted to the upside, given the possibility of additional measures in an election year.

Fiscal* and Quasi-fiscal Impulse Contribution



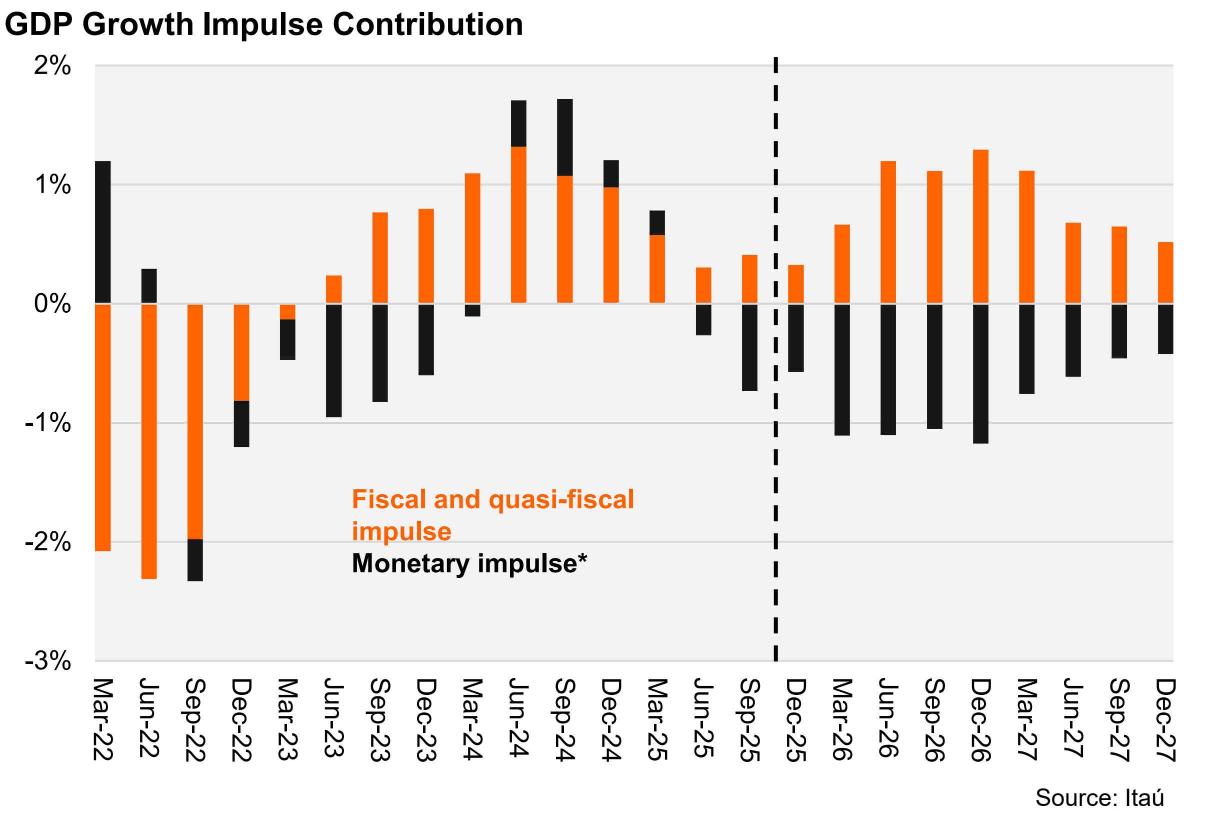
Source: Itaú

*Fiscal Impulse: 4Q Moving average of (transfer expenditures in t minus transfer expenditures in t–4)/ GDPt-4. Transfer expenditures include spending on social security benefits, wage bonuses and unemployment insurance, LOAS and RMV benefits, Bolsa Família, and extraordinary credit.

Activity: moderate deceleration

1. 2027 GDP at 1.7%. What factors are driving growth?

- Lower fiscal impulse being offset by a less restrictive monetary policy.



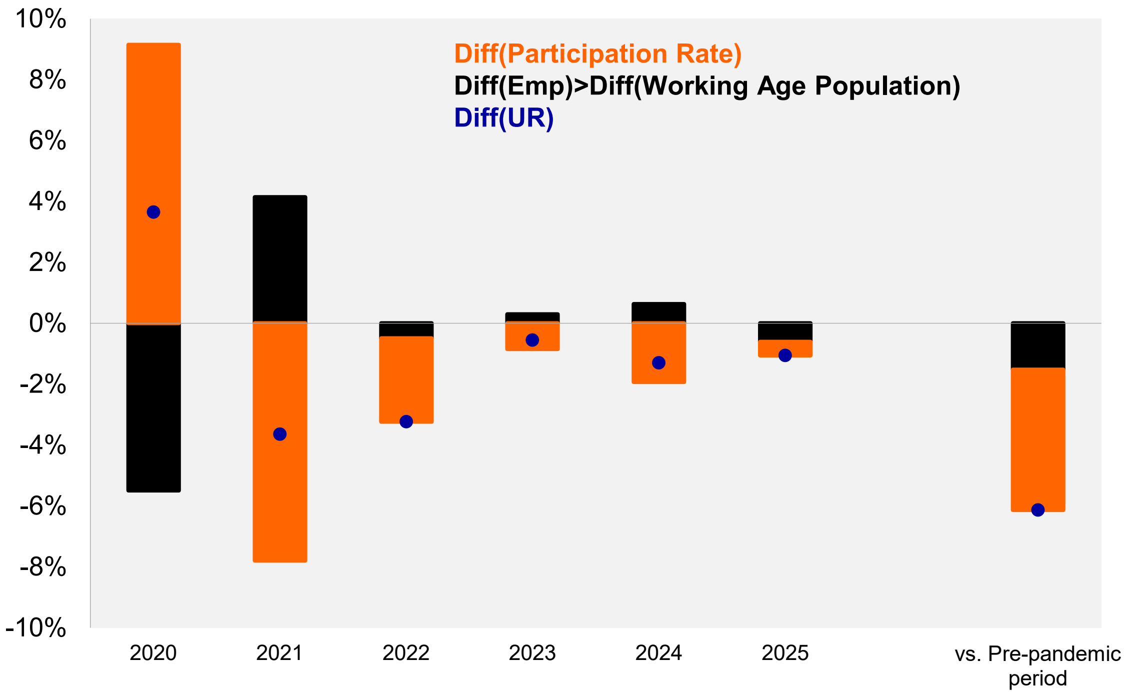
*Monetary impulse: average of the interest-rate and credit impulses (Core household credit, Core corporate credit, housing credit, and capital markets).

Activity: moderate deceleration

2. What explains the recent labor market dynamics? What is the outlook for 2026?

- Cyclical factors show early signs of moderation in the labor market, but structural factors make it difficult to assess the degree of tightness.
- Unemployment has declined by roughly 6 p.p. relative to pre-pandemic levels, with a 4.6 p.p. contribution from higher employment (employed population) and 1.5 p.p. from a lower labor force participation rate. Even after accounting for structural factors, an unemployment rate around ~5.5%-6.0% still signals a tight labor market.
- With growth set to slow but no recovery in the participation rate ahead, **we project unemployment at 5.5% in 2025, 5.7% in 2026, and 6.0% in 2027.**

Change in unemployment (in p.p.)



Source: IBGE, Itaú

		Impact on Employment	Impact on Participation Rate	Impact on Unemployment
Cyclical Factors	Growth above potential	↑	--	↓
	Post-pandemic recovery led by labor-intensive sectors	↑	--	↓
	Increased share of fiscal transfers in household income	--	↓	↓
Structural Factors	Labor reform boosting formalization	↑	--	↓
	Demographic and educational shifts	↓	↓	?*
	Introduction of digital labor platforms	↑	↓	↓

*BCB's Monetary Policy Report of Sep/25 showed that the effect of the decline in the participation rate offset the drop in the labor force, leading to a decrease in unemployment.

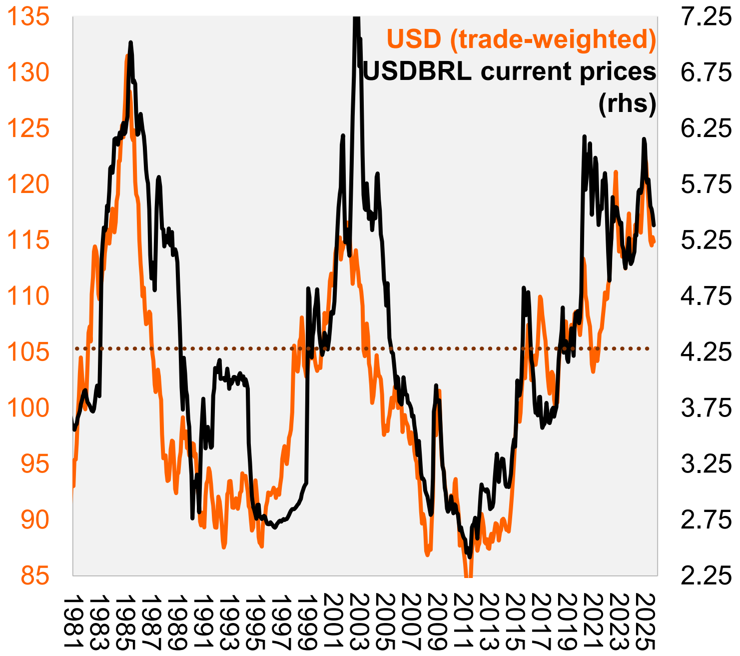
Source: Itaú

BRL: limited room for sustained appreciation

3. Benign external environment versus domestic uncertainty: which factor will drive FX dynamics throughout the year?

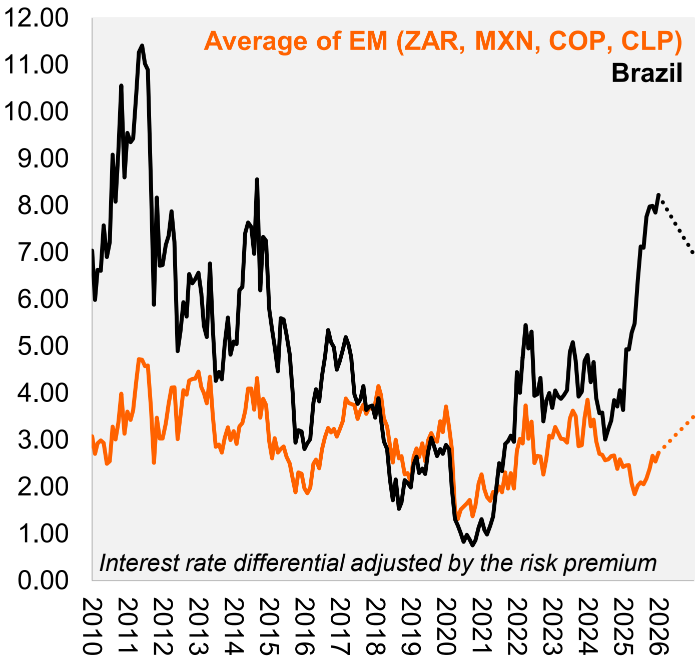
- A weaker global dollar (with a more dovish Fed) supports emerging market currencies (stronger BRL)
- Interest rate differential remains a buffer: even as it declines, it will stay high compared to peers (stronger BRL)
- With the electoral outlook still uncertain, the risk premium is set to remain under pressure (particularly in 2Q) (weaker BRL)
- **We forecast the exchange rate at BRL 5.50 per dollar in 2026 and BRL 5.70 per dollar in 2027.**

Weaker USD globally



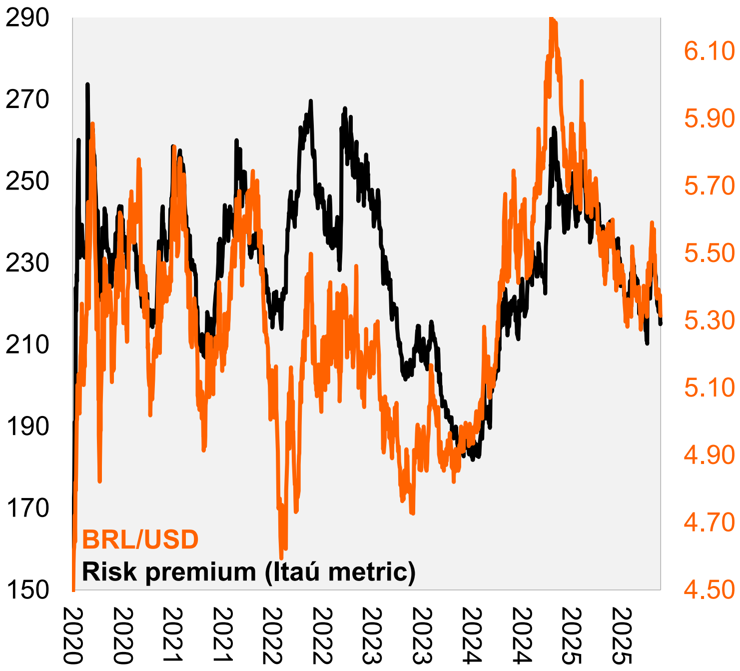
Source: Bloomberg, Itaú

Interest rate differential still acts as a buffer



Source: Bloomberg, Itaú

Risk premium tends to remain under pressure



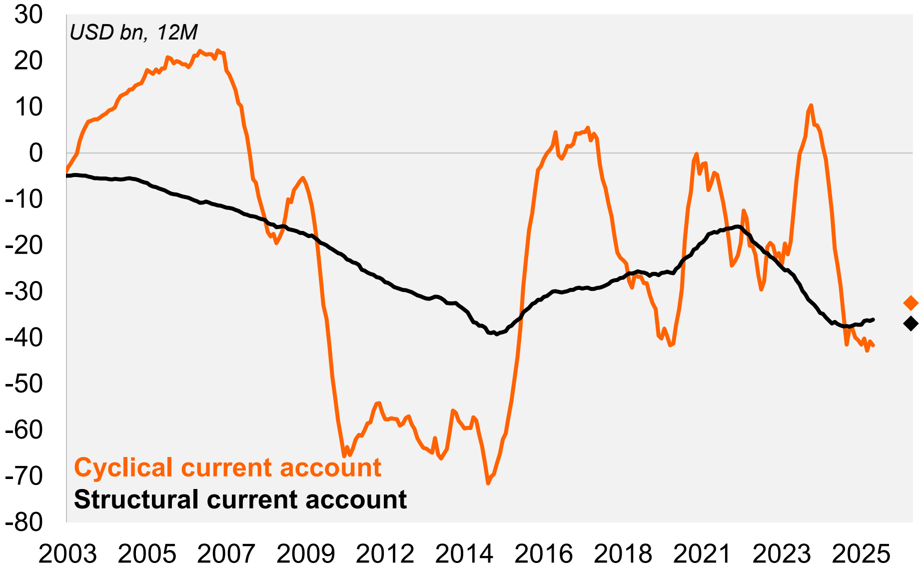
Source: Bloomberg, Itaú

BRL: limited room for sustained appreciation

4. The deterioration of external accounts constrained the BRL appreciation in 2025. What should we expect for 2026?

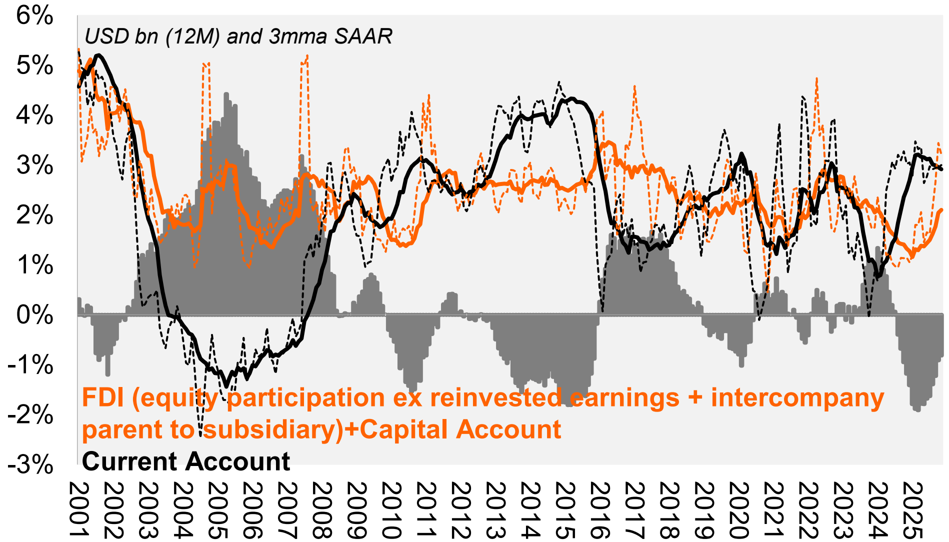
- In 2025, a current account deficit larger than foreign direct investment (FDI) inflows limited BRL appreciation. At the margin, conditions improved, but not enough to support a more meaningful strengthening of the currency.
- We do not anticipate additional deterioration in 2026, although improvement is set to be gradual: (i) economic activity moderation; but (ii) structural weaknesses in the current account (related to items with limited correlation to the economic cycle and the BRL) result in a slower adjustment path.
- **We revised our trade balance forecast to USD 74 billion in 2026 (from USD 65 billion) and USD 75 billion in 2027 (from USD 70 billion). As a result, our current account deficit projections were also revised to USD 70 billion in 2026 (from USD 77 billion) and USD 68 billion in 2027 (from USD 71 billion), equivalent to 2.9% and 2.7% of GDP, respectively, still above the historical average.**

Current account: slight cyclical improvement and structural deterioration*



Source: BCB, Itaú

The deterioration of external accounts constrained the BRL appreciation in 2025



Source: BCB, Itaú

*Cyclical: Trade balance, income, travel, transport, others / Structural: Equipment rentals, cultural, personal and recreational services, intellectual property services, telecommunications, computer and information services, others.

Inflation: IPCA within the tolerance band

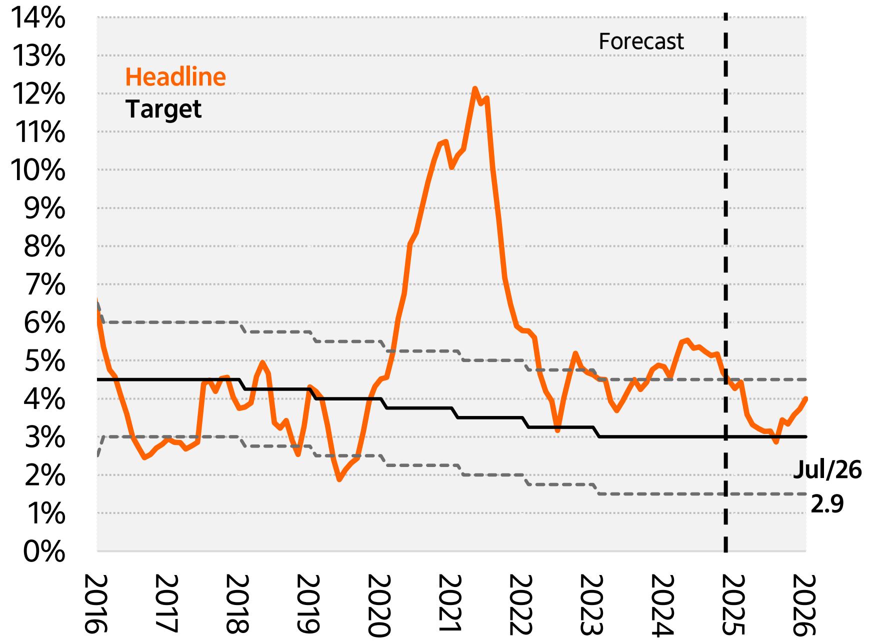
5. What should we expect for 2026 and 2027? What are the main risks?

- **We forecast IPCA at 4.0% inflation in 2026,** reflecting deceleration in goods and services prices, while food prices are likely to rise amid the protein cycle. The lowest 12-month inflation reading will come in July (2.9%).
- The balance of risks is tilted to the downside for food (higher domestic meat availability due to lower exports) and for goods (elevated inventory levels). By contrast, we see upside risks in services, particularly auto insurance.
- **For 2027, we also project IPCA at 4.0%**, with a still-resilient labor market keeping services inflation under pressure.

Weight	Description	2024	2025	2026	2027
100.0	IPCA	4.8	4.3	4.0	4.0
73.7	Market-Set prices	4.9	3.9	4.1	3.9
15.4	Food at home	8.2	1.4	5.0	4.6
22.9	Industrial	2.9	2.4	1.3	1.3
15.5	Underlying Industrial	2.4	3.2	2.0	1.6
35.3	Services	4.8	6.0	5.5	5.1
21.1	Underlying services	5.8	5.8	5.8	5.2
26.3	Regulated prices	4.7	5.3	3.7	4.3
4.3	Eletricity	-0.4	12.3	6.1	6.2
5.2	Gasoline	9.7	1.9	0.2	0.0

Source: IBGE, Itaú

IPCA: 12 months



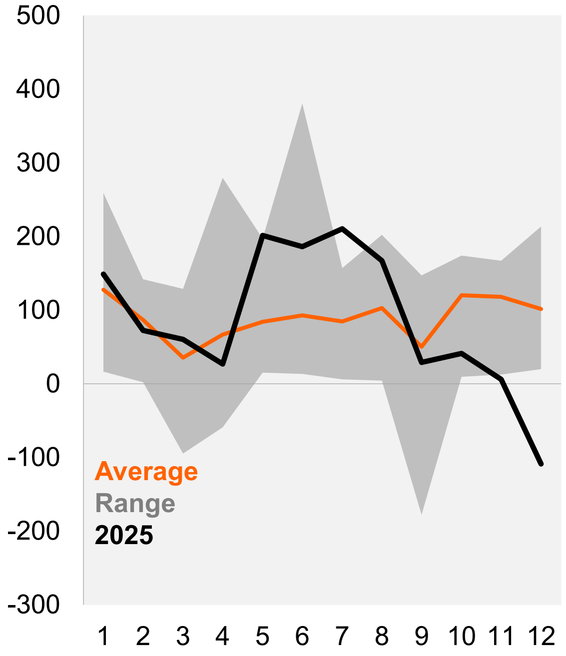
Source: IBGE, Itaú

Inflation: IPCA within the tolerance band

6. Could downside risks in tradable goods bring inflation closer to the target?

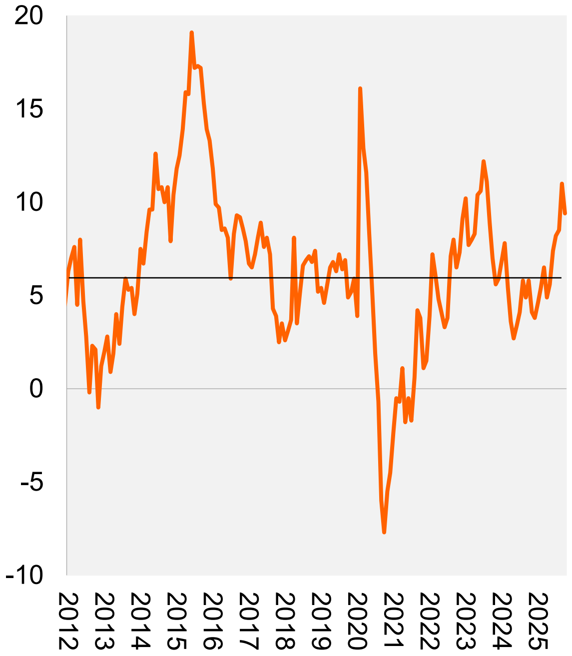
- Food: we expect upward pressure over the year amid lower domestic meat availability. However, limits on Chinese imports of Brazilian meat could offset the tighter supply, with a downside impact on our inflation forecast of up to -20 bps, particularly in the second half.
- Industriais: disinflation is driven by elevated inventories and a stronger BRL (on average). Slower activity (which may keep inventories high for longer) and decreasing prices of Chinese imports represent downside risks to goods inflation of up to -20 bps.
- Despite these downside risks in tradables, service inflation will likely remain as a key source of pressure on 2026 IPCA.

Domestic availability of meat (Slaughter + Imports - Exports)



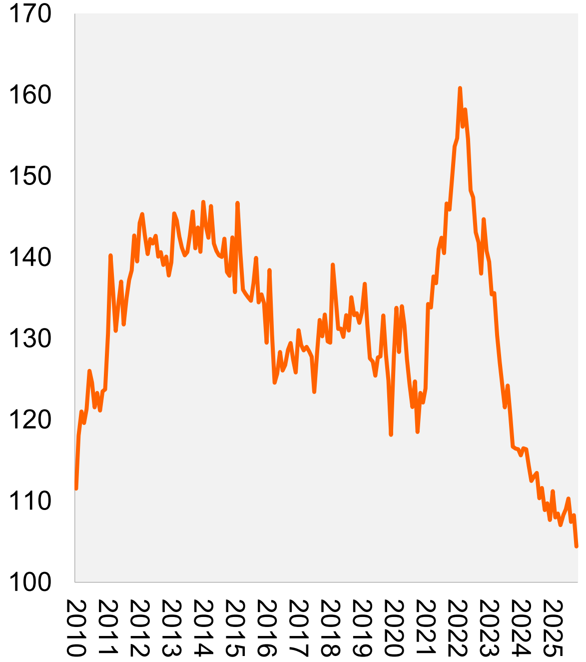
Source: MAPA, Comex Stat, Itaú

Inventories (excessive - insufficient)



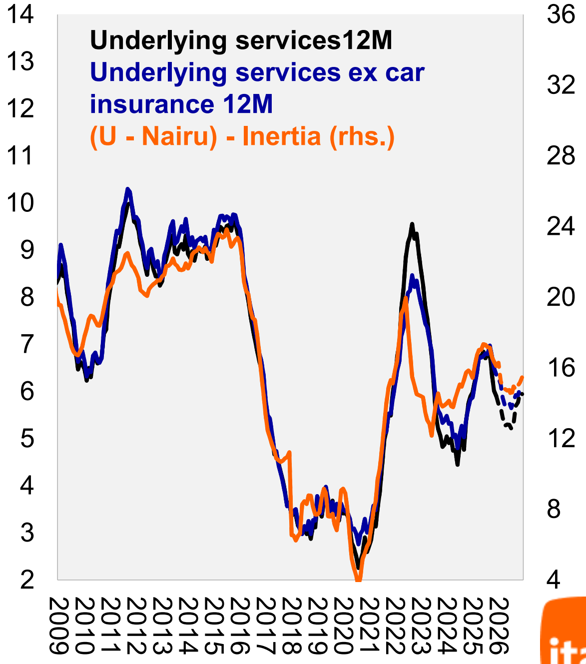
Source: FGV

Import price index – China origin



Source: Monitor Comércio Exterior

Services core



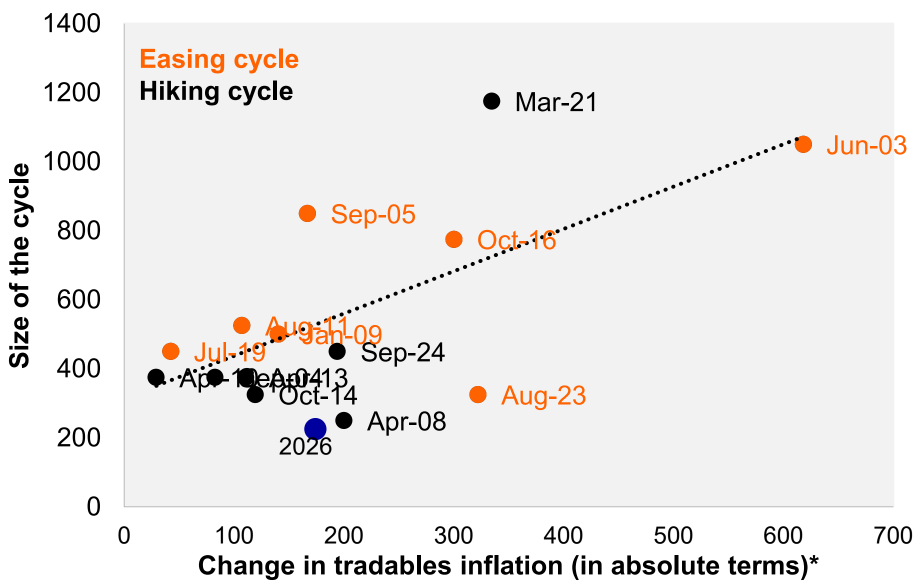
Source: IBGE, Itaú

Monetary policy: approaching the beginning of an easing cycle

7. When will it start, and how large will it be?

- The Copom continues to see evidence that the current monetary policy strategy is working, with signs of moderation in activity and consumption and improving inflation dynamics, creating conditions for the start of the easing cycle.
- However, disinflation remains concentrated in tradable goods, which calls for caution in interpreting the inflation outlook, as deeper or faster easing cycles could negatively affect the currency, particularly in a context of still-resilient non-tradable inflation.
- **We expect the start of the rate-cutting cycle to be postponed to March (with -25 bps; previously expected for January).**
- **The Selic rate is set to reach 12.75% p.a. in 2026 and 11.75% p.a. in 2027**, gradually reducing the degree of monetary restrictiveness while remaining in contractionary territory.

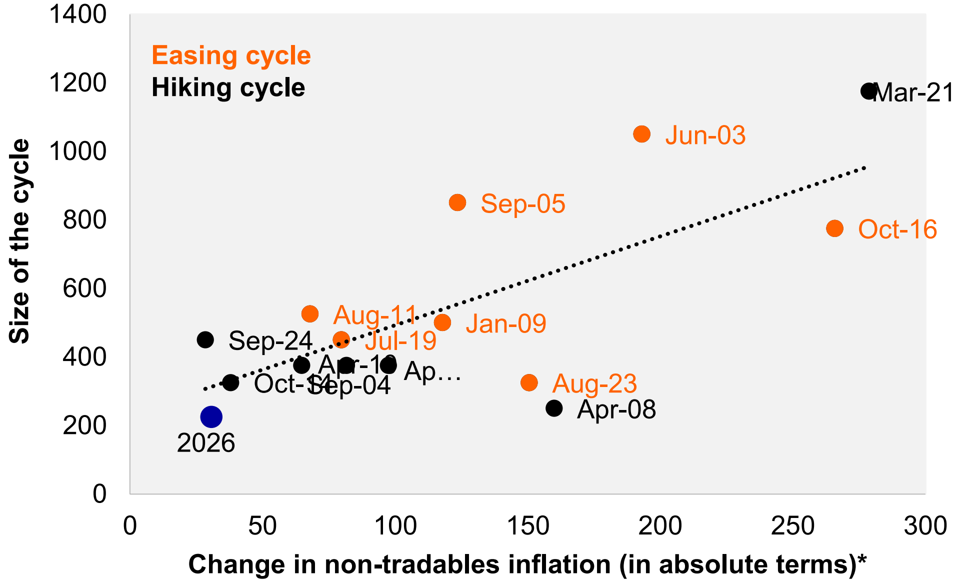
Change in tradables inflation and the size of the cycle



Source: Itaú

*Inflation delta: (high-low) or (low-high) in 12 months

Change in non-tradables inflation and the size of the cycle



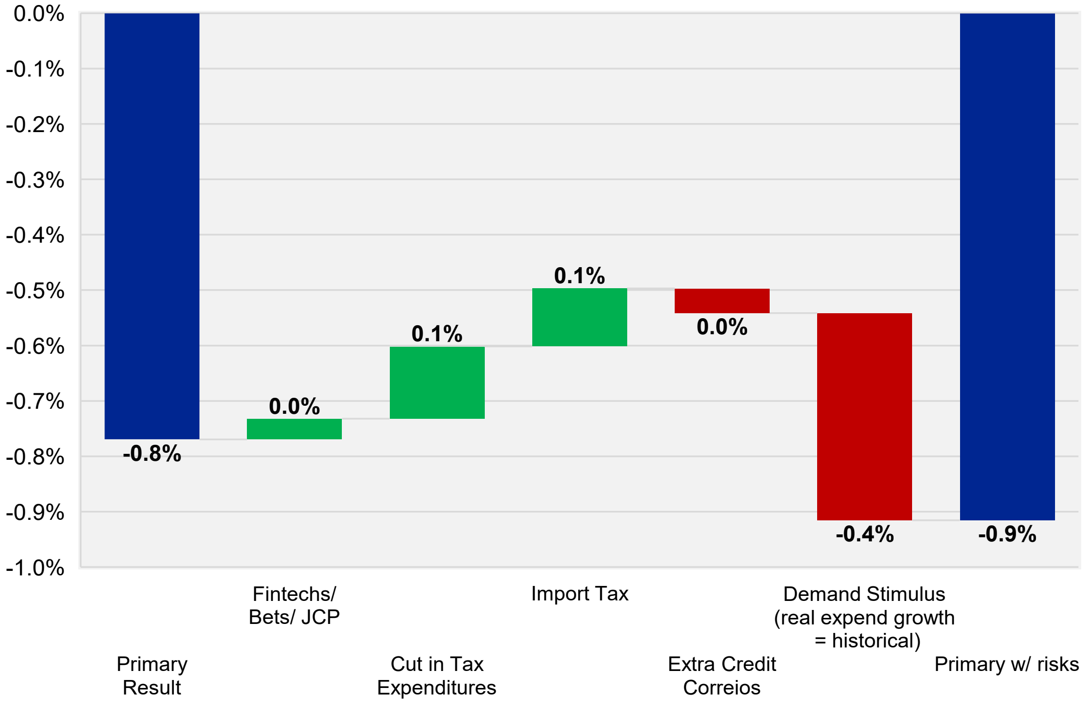
Source: Itaú

Public accounts: stimulus amid electoral uncertainty

8. Additional demand-side stimulus remains the main fiscal risk in 2026

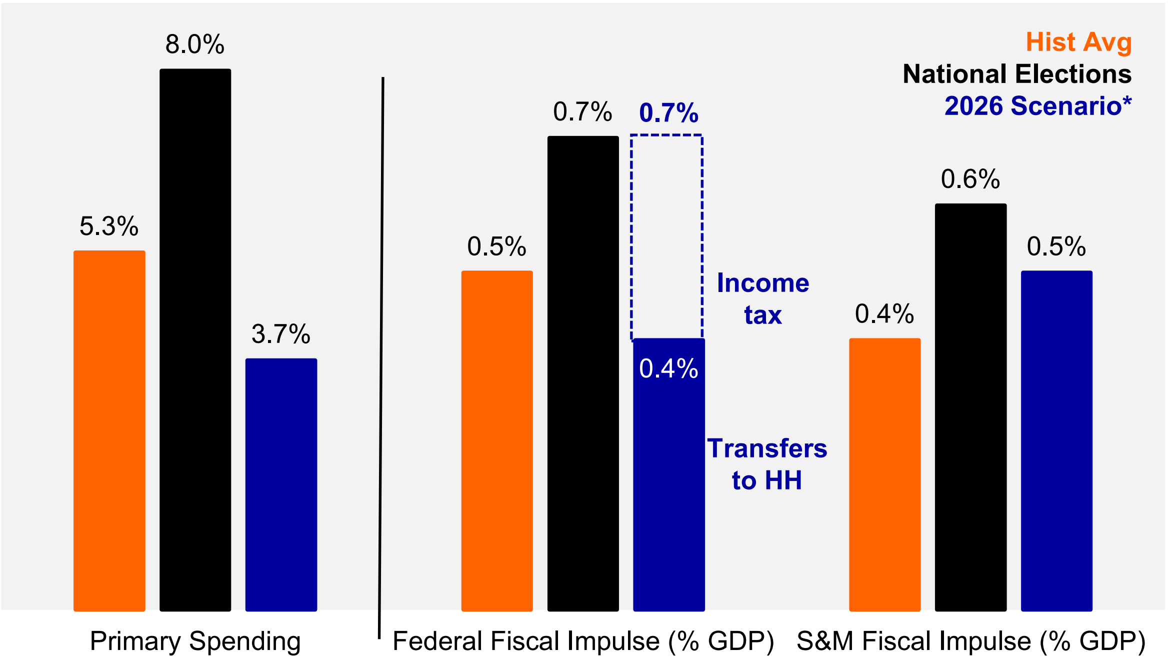
- We expect a primary balance of -0.8% of GDP in 2026, implying a 0.3% of GDP challenge to meet the effective lower bound of the target.
- Despite the expected fiscal impulse (considering the personal income tax exemption) approaching historical levels observed in election years, the main risk remains expenditure execution above the framework's spending cap, either explicitly through exemptions or via rule flexibilization.

Primary result 2026: balance of risks



Source: Itaú

Fiscal variables and stimuli



*2026 scenario includes income tax exemption as a federal stimulus

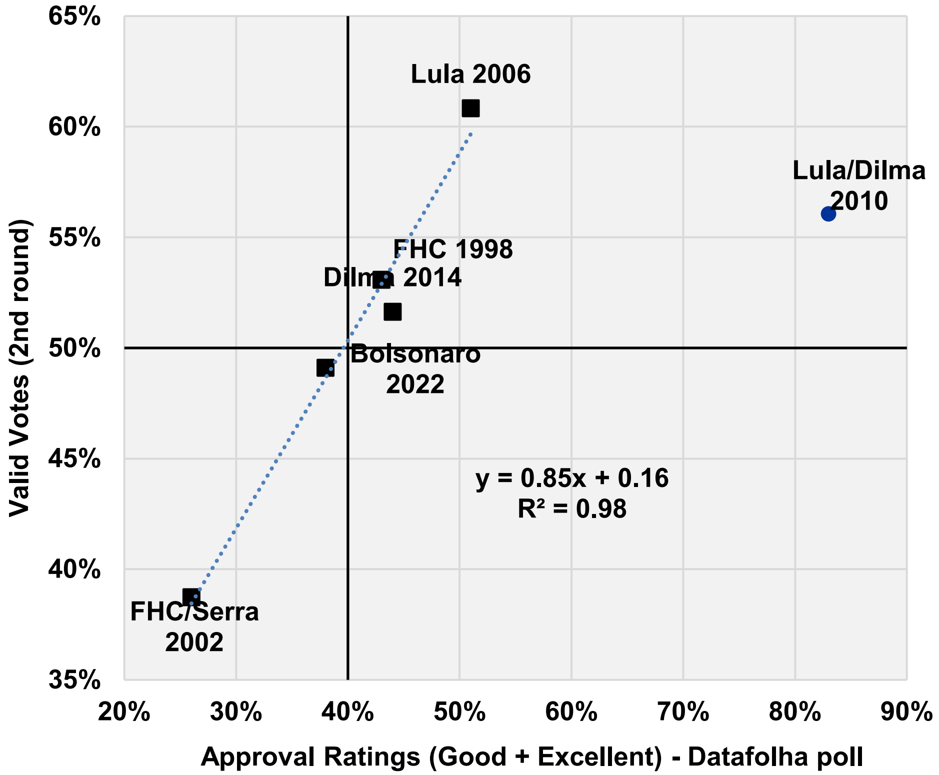
Source: National Treasury, Itaú

Elections and the fiscal challenge for the next administration

9. Elections: the race is expected to be tight

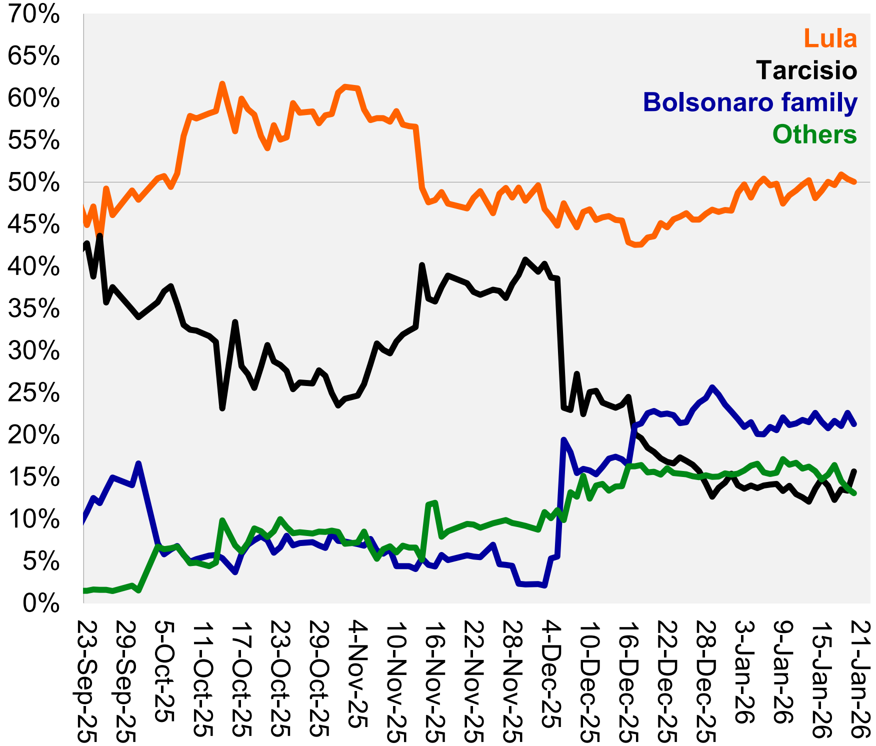
- While government approval remains below the level historically required for reelection, public polls and betting markets indicate roughly a 50% chance of reelection.

Valid votes X Approval ratings



Source: Datafolha, TSE

Probabilities in the 2026 election
Average of de Polymarket and Kalshi



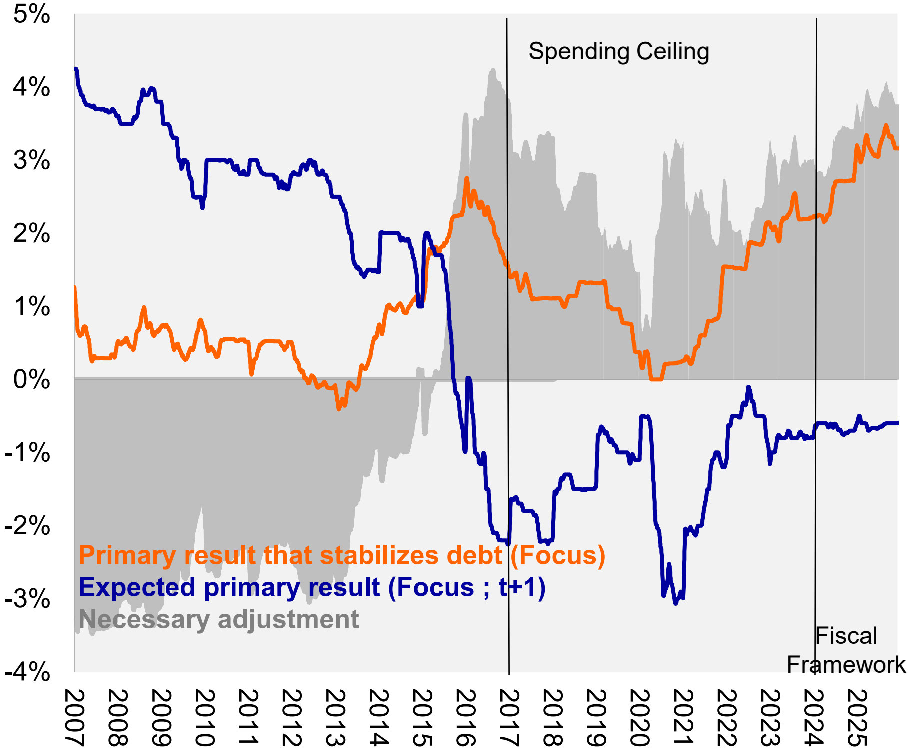
Source: Polymarket, Kalshi

Elections and the fiscal challenge for the next administration

9. Will the elected government signal a fiscal adjustment in the next presidential term?

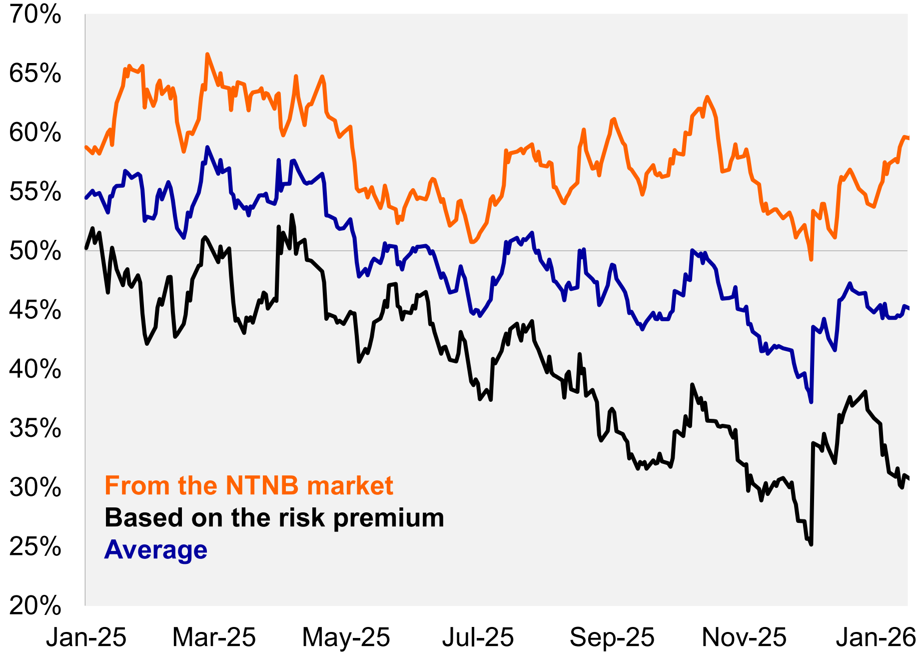
- Despite the need of a fiscal adjustment to stabilize public debt (approximately 4 p.p. of GDP), asset prices suggest roughly a 50% probability that the adjustment will be carried out.

Focus survey: estimated primary result vs necessary primary result to stabilize debt



Source: BCB

Implicit probability of a government without fiscal adjustment



Source: Bloomberg, Itaú

$$Risk\ premium_T = x\%_T . Risk\ premium_{no\ fiscal\ adjustment} + (1 - x\%)_T . Risk\ premium_{with\ fiscal\ adjustment}$$

330 170

$$NTNB45_T = x\%_T . NTNB45_{no\ fiscal\ adjustment} + (1 - x\%)_T . NTNB2045_{with\ fiscal\ adjustment}$$

9% 5%

Elections and the fiscal challenge for the next administration

10. Fiscal adjustment: what is the size of the required adjustment?

How to stabilize the debt-to-GDP ratio at 80%?

- A significant fiscal adjustment, taking the primary balance to ~3% of GDP (a total consolidation of roughly 4 p.p. of GDP)
- Without fiscal adjustment and under an extreme scenario of financial repression (real interest rate < 0%), inflationary spiral

Primary result that stabilizes debt in 80% of GDP				
GDP / real rates	**4.0%**	**5.0%**	**6.0%**	**7.0%**
1.5%	2.0%	2.8%	3.6%	4.4%
2.0%	1.6%	2.4%	3.2%	4.0%
2.5%	1.2%	2.0%	2.8%	3.6%
3.0%	0.8%	1.6%	2.4%	3.2%

Source: Itaú

Real Rate that stabilizes debt in 2030						
		Real growth of expenditure y/y (2026–2030)				
		0.0%	**1.0%**	**2.5%**	**3.5%**	**6.0%**
GDP (2026-2030)	**0.0%**	-0.7%	-1.4%	-2.5%	-3.1%	-4.7%
	1.0%	1.0%	0.2%	-0.8%	-1.5%	-3.2%
	2.0%	2.7%	1.9%	0.8%	0.1%	-1.6%
	3.0%	4.5%	3.7%	2.6%	1.8%	0.0%

Selic held at 10% between 2026 and 2030.

Source: Itaú

BRAZIL | Forecasts

	2022	2023	2024	2025F		2026F		2027F	
				Current	Previous	Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	3.0	3.2	3.4	**2.3**	2.3	**1.9**	1.7	**1.7**	1.7
Nominal GDP - BRL bn	10,080	10,943	11,779	**12,708**	12,718	**13,370**	13,348	**14,141**	14,111
Nominal GDP - USD bn	1,951	2,192	2,186	**2,273**	2,279	**2,437**	2,458	**2,521**	2,516
Population (millions)	210.9	211.7	212.6	**213.4**	213.4	**214.2**	214.2	**215.0**	215.0
Per Capita GDP - USD	9,255	10,356	10,281	**10,650**	10,677	**11,376**	11,473	**11,730**	11,705
Nation-wide Unemployment Rate - year avg	9.5	8.0	6.9	**5.9**	6.0	**5.6**	5.9	**5.9**	6.0
Nation-wide Unemployment Rate - year end (*)	8.4	7.9	6.6	**5.5**	5.8	**5.7**	6.0	**6.0**	6.2
Inflation									
IPCA - %	5.8	4.6	4.8	**4.3**	-	**4.0**	4.0	**4.0**	4.0
IGP–M - %	5.5	-3.2	6.5	**-1.1**	-	**3.7**	3.1	**3.7**	3.7
Interest Rate									
Selic - eop - %	13.75	11.75	12.25	**15.00**	-	**12.75**	12.75	**11.75**	11.75
Balance of Payments									
BRL / USD - eop	5.28	4.86	6.18	**5.35**	-	**5.50**	5.50	**5.70**	5.70
BRL / USD - average	5.17	4.99	5.39	**5.59**	-	**5.49**	5.49	**5.61**	5.61
Trade Balance - USD bn	62	99	75	**68**	-	**74**	65	**75**	70
Current Account - % GDP	-2.2	-1.2	-3.0	**-3.3**	-3.5	**-2.9**	-3.1	**-2.7**	-2.8
Direct Investment (liabilities) - % GDP	4.0	2.9	3.4	**3.7**	3.7	**3.8**	3.7	**4.1**	4.1
International Reserves - USD bn	325	355	330	**360**	-	**360**	360	**360**	360
Public Finances									
Primary Balance - % GDP	1.2	-2.3	-0.4	**-0.5**	-0.5	**-0.8**	-0.8	**-0.9**	-0.9
Nominal Balance - % GDP	-4.6	-8.8	-8.5	**-8.5**	-8.5	**-8.9**	-8.8	**-8.4**	-8.5
Gross Public Debt - % GDP	71.7	73.8	76.3	**78.8**	78.8	**84.0**	84.0	**88.1**	88.1
Net Public Debt - % GDP	56.1	60.4	61.3	**65.4**	65.6	**71.0**	71.0	**75.1**	75.3
Growth of public spending (% real, pa, **)	6.0	7.6	3.2	**4.1**	4.2	**3.7**	3.4	**2.5**	2.5

Source: IBGE, FGV, BCB and Itaú

(*) Nation-wide Unemployment Rate measured by PNADC, Seasonelly Adjusted

(**) 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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