Macro Research

Monthly Scenario Review - Brazil
August 2024

BRAZIL: Main themes for 2H24

BRL remains under pressure: Is there room for a rebound?

1. Limited room for appreciation, given: (i) still-supported USD, (ii) higher risk premium and (iii) current account deterioration as trade surplus lost momentum.

Activity: Additional upward surprises? How far can it go?

2. New upward revision for the year, with resilient activity in 1H24. Fundamentals still point to a slowdown in 2H24 and 2025;
3. Resilient job market, with no signs of deceleration.

Inflation: Are risks still largely skewed upward?

4. Low inflation mid-year, but the best moment for inflation in qualitative terms is going by;
5. There is still upward asymetry in risks (mainly due to the BRL and job market).

Selic: How close is Brazil to a tightening cycle?

6. Inflation expectations are dis-anchored and getting worse;
7. We maintain our forecast for the Selic rate at 10.50%pa until the end of 2025, for now. But with higher risks, leeway is decreasing.

Fiscal: Compliance with the fiscal framework?

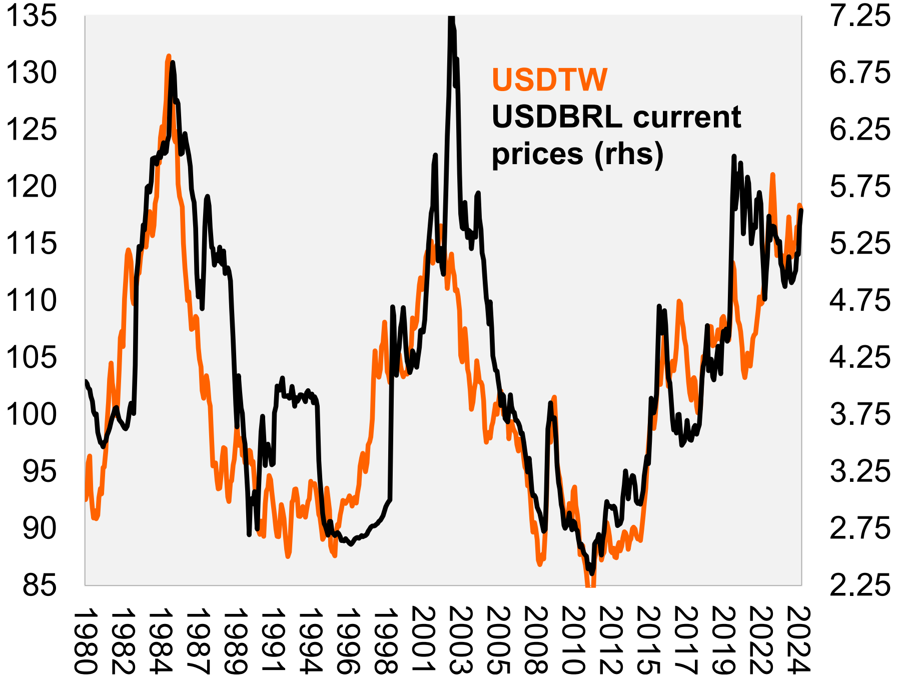
8. We maintain our estimates for primary budget results of -0.6% in 2024 and -0.9% in 2025;
9. Spending adjustment of BRL 22 billion needed to meet the framework limit in 2024.

BRL remained under pressure: Is there room for a rebound?

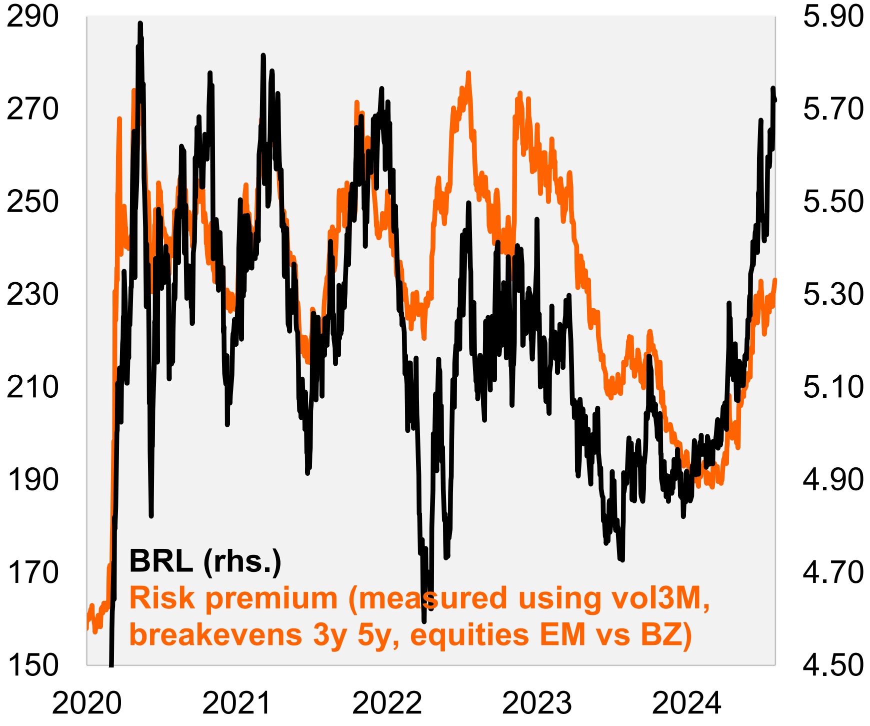
1. We revised our estimates to 5.50 reais per dollar in 2024 and 2025 (from 5.30 and 5.40, respectively)

- Fundamentals still point to a depreciated currency, including (i) still-supported USD and (ii) higher domestic risk premium.
- We expect a rebound to some extent due to risk premium accommodation and/or interest rate cuts in the US.

BRL depreciates amid a scenario of strong USD...



... and higher risk premium



Source: BBG, Itaú

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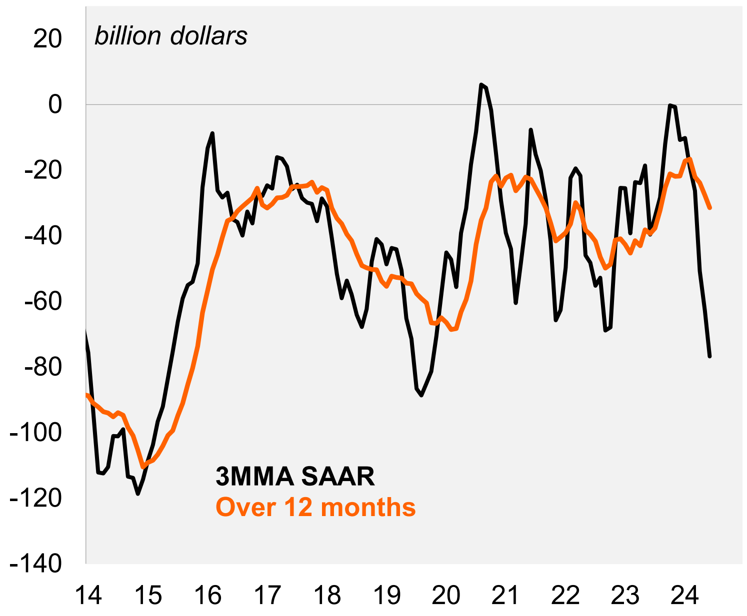
BRL remained under pressure: Is there room for a rebound?

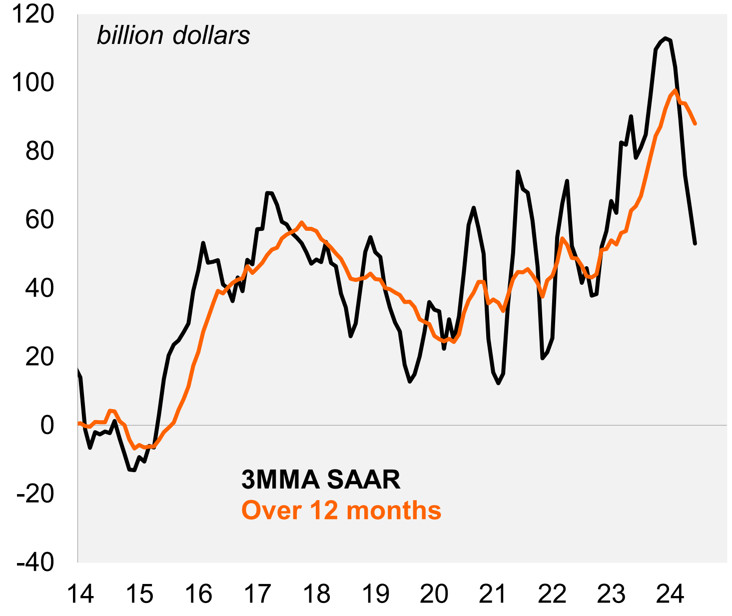
1. We revised our estimates to 5.50 reais per dollar in 2024 and 2025 (from 5.30 and 5.40, respectively)

- Current account deterioration as trade balance loses momentum and services and income deficits widen.
- We revised our current account deficit projections to $43 billion (from $27 billion) in 2024, $46 billion (from $37 billion) in 2025.
- We revised our trade surplus projections to $75 billion (from $85 billion) in 2024, $70 billion in 2025 due to falling exports (price effect) and rising imports.

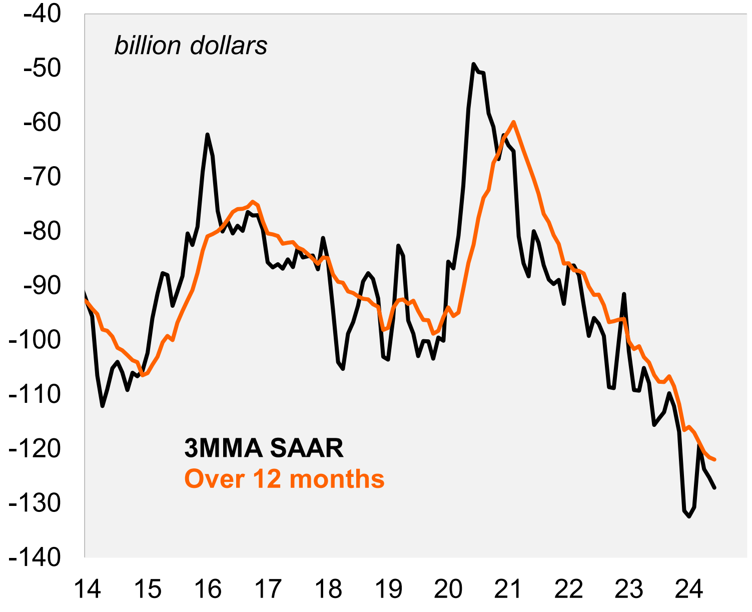
Higher current account deficit



Due to weaker trade surplus



and higher services and income deficits



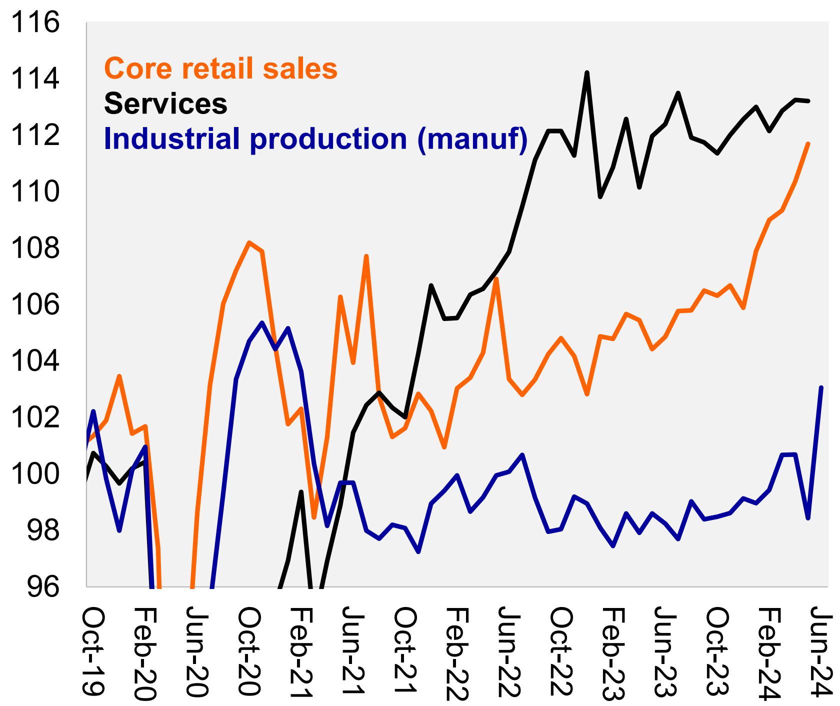
Source: BCB, Itaú

Activity: Additional upward surprises? How far can it go?

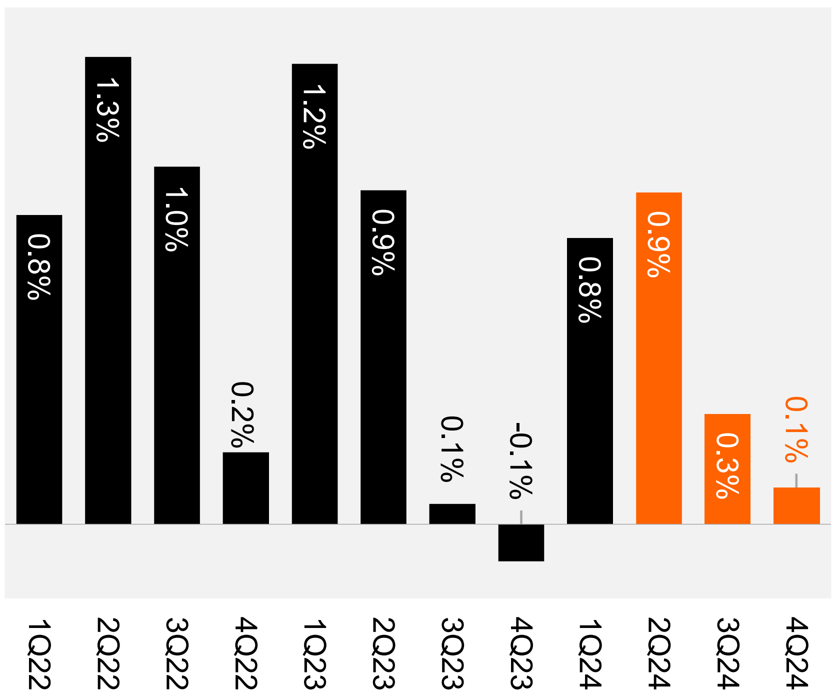
2. New upward revision for the year with resilient activity in 1H24.

- Resilient activity in 1H24: 2Q24 GDP tracking at 0.9% qoq/sa (2.6% yoy).
- We revised our estimate for 2024 GDP to 2.5% (from 2.3%). Floods in Rio Grande do Sul state impacted activity in May (especially in the industrial sector), but the aggregate impact in the year was small.

Stronger activity data in 1st semester



GDP Growth (%, QoQ)



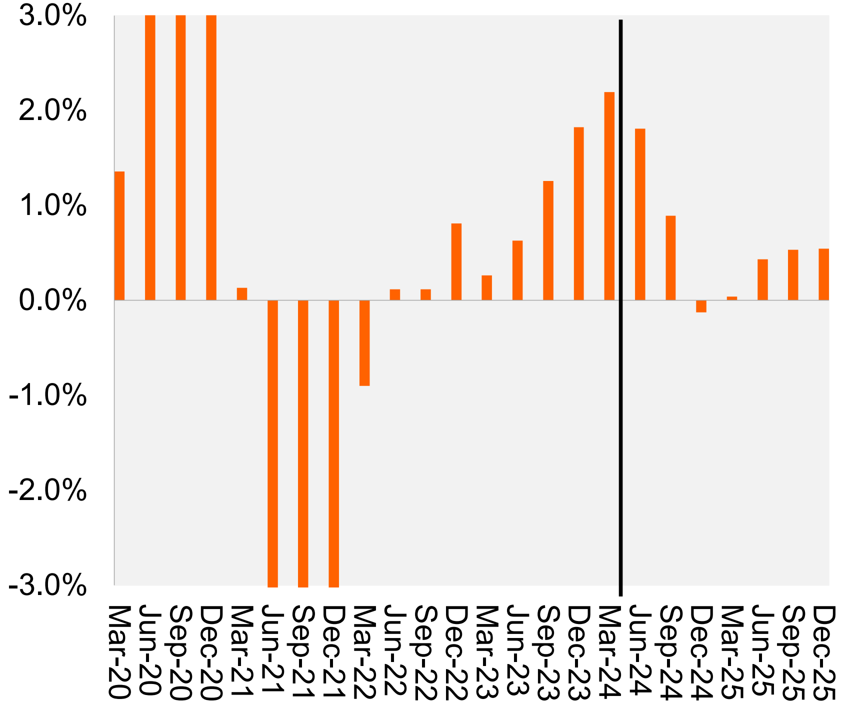
Source: IBGE, Itaú

Activity: Additional upward surprises? How far can it go?

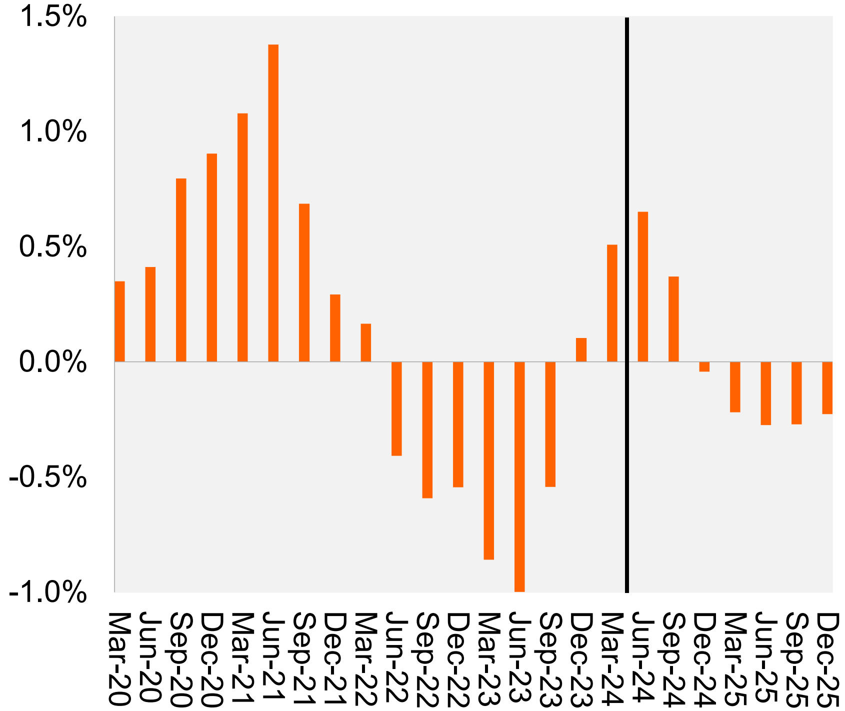
2. Fundamentals still point to some deceleration in 2H24 and 2025

- We maintained our call of a slowdown in growth to 1.8% in 2025.
- Negative monetary momentum, with interest rates in contractionary territory and slowing credit going forward. Fiscal momemtum should remain positive in 2025, but less than this year.

Fiscal momentum



Monetary momentum



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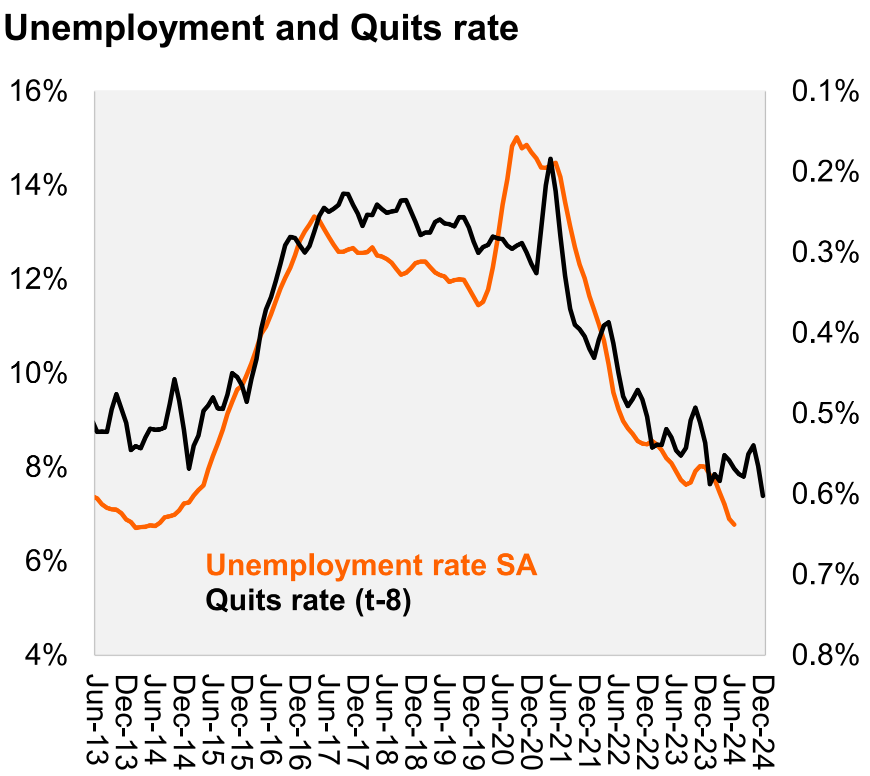
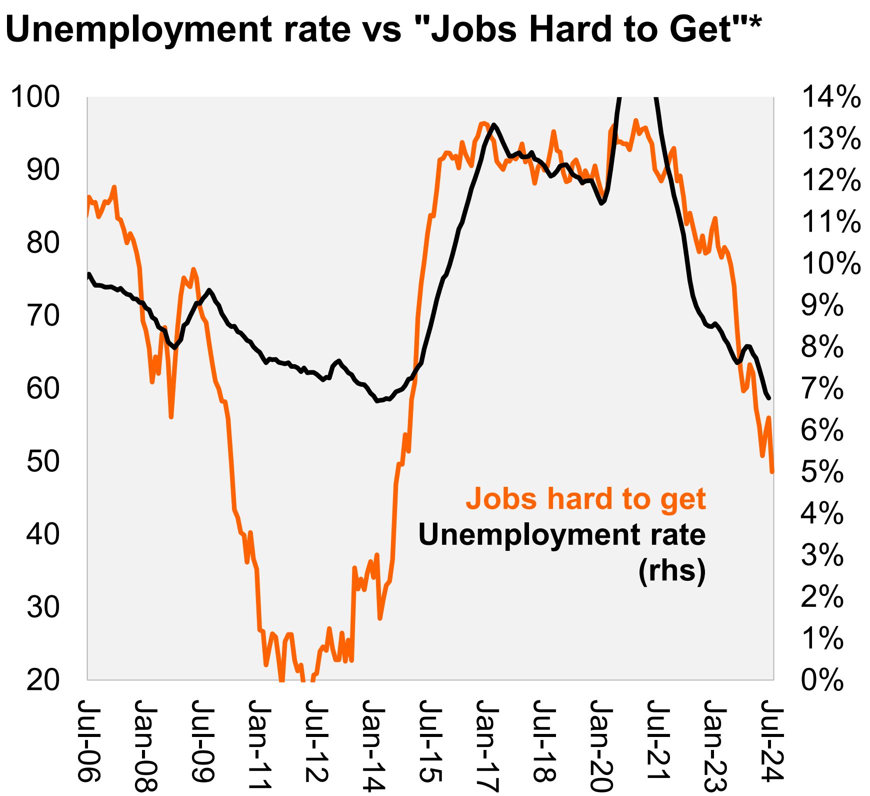
Source: BCB, IBGE, Itaú

Activity: Additional upward surprises? How far can it go?

3. Resilient job market, with no signs of deceleration

- Data released until 2Q24 (with rising formal employment exerting pressure on real wages) and the outlook for stronger GDP point to a lower unemployment rate by year-end.
- We have revised our estimates for the unemployment rate to 7.3% (from 7.8%) in 2024 and to 7.5% (from 8.0%) in 2025.





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

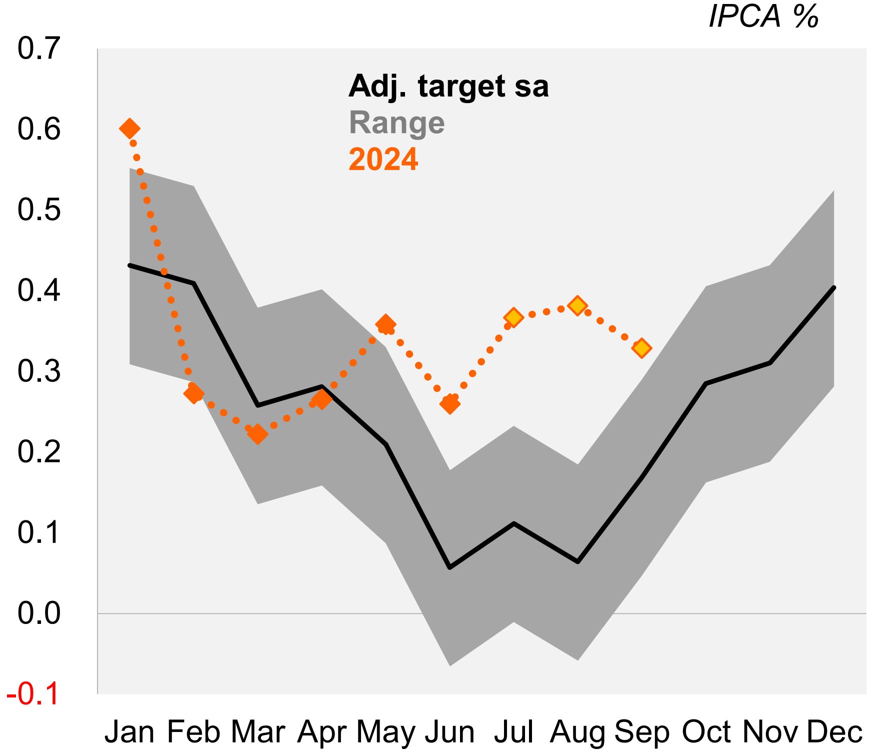
Source: FVG, IBGE, Itaú

Inflation: Are risks still largely skewed upward?

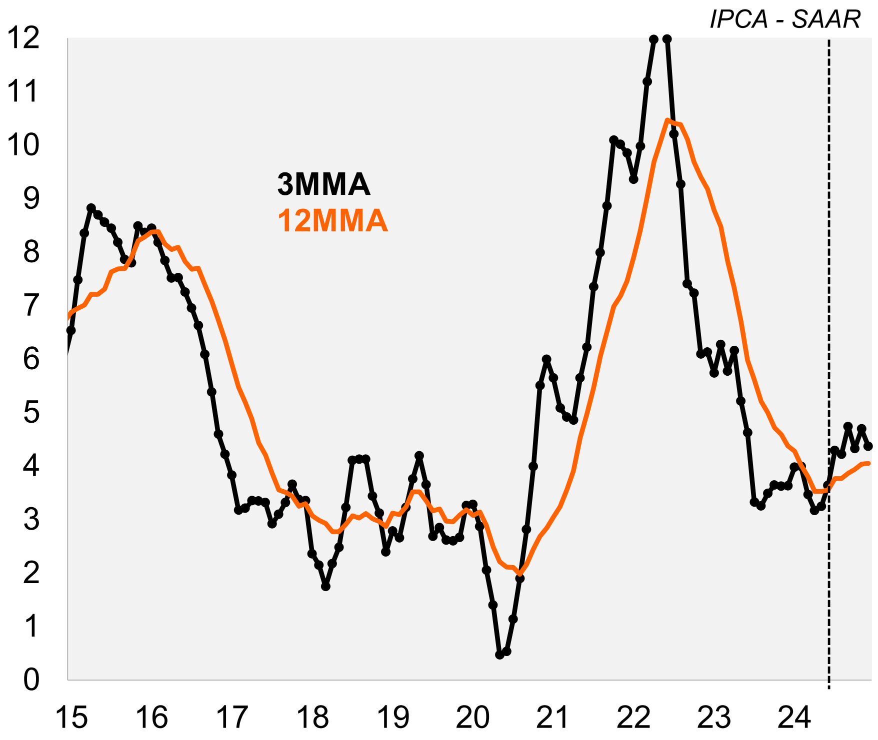
4. Low inflation mid-year, but the best moment for inflation in qualitative terms is going by

- Low readings in June-September: (i) reversal of the shock in fresh food prices, (ii) effect of regulated prices behind us (gasoline price adjustment + yellow/green flag in the electricity tariff system).
- Acceleration in the average of core inflation measures published by the Central Bank from July onwards (upcoming report) driven by underlying services.

Headline



Core average - BCB



Source: BCB, IBGE, Itaú

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Inflation: Are risks still largely skewed upward?

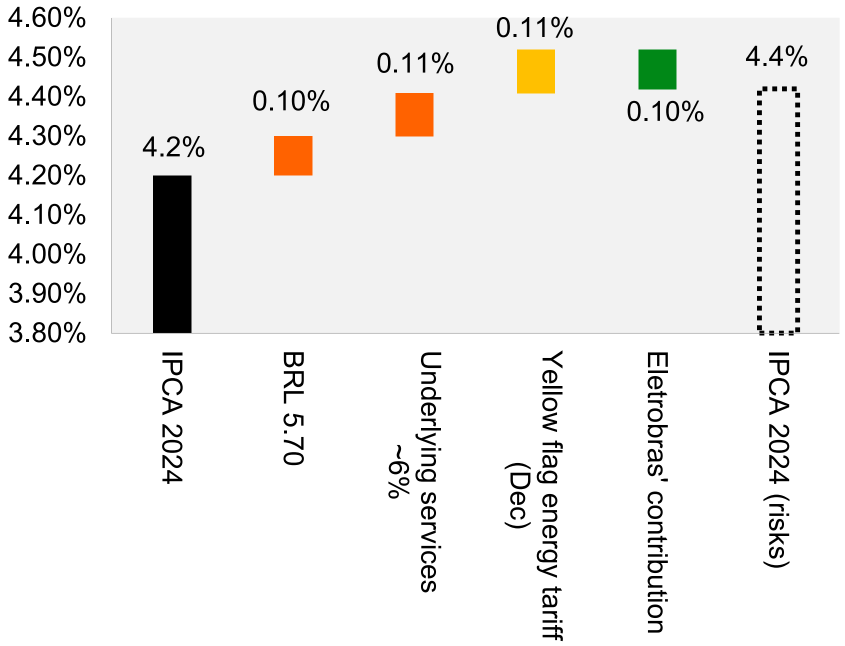
5. We revised our IPCA forecasts to 4.2% (from 4.0%) in 2024 and to 4.2% (from 4.0%) in 2025

- We incorporated a stronger acceleration in services prices next year as the labor market gets even tighter.
- The balance of risks for both years remains upwardly asymmetrical: (i) weaker BRL, (ii) more pressure on underlying services prices.

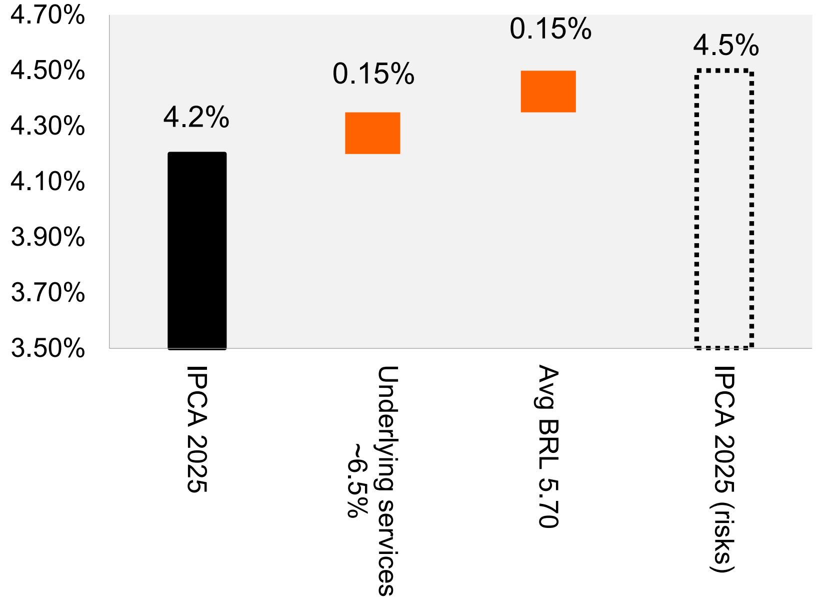
Weight		2020	2021	2022	2023	2024	2025
100.0	IPCA	4.5	10.1	5.8	4.6	4.2	4.2
74.1	Market-Set prices	5.2	7.7	9.4	3.1	4.0	4.5
15.1	Food at home	18.2	8.2	13.2	-0.5	4.3	5.1
23.4	Industrial	3.2	11.9	9.5	1.1	3.1	2.6
15.8	Underlying industrial	2.3	8.7	14.0	2.3	2.5	2.9
35.5	Services	1.7	4.8	7.6	6.2	4.5	5.6
21.0	Underlying services	2.5	5.9	8.9	4.8	5.6	6.0
36.8	IPCA-EX3	2.4	7.1	11.1	3.7	4.3	4.7
25.9	Regulated prices	2.6	16.9	-3.8	9.1	4.7	3.4
4.1	Electricity	9.1	21.2	-19.0	9.5	0.4	4.8
5.0	Gasoline	-0.2	47.5	-25.8	12.1	10.5	0.5

Source: IBGE, Itaú

IPCA 2024



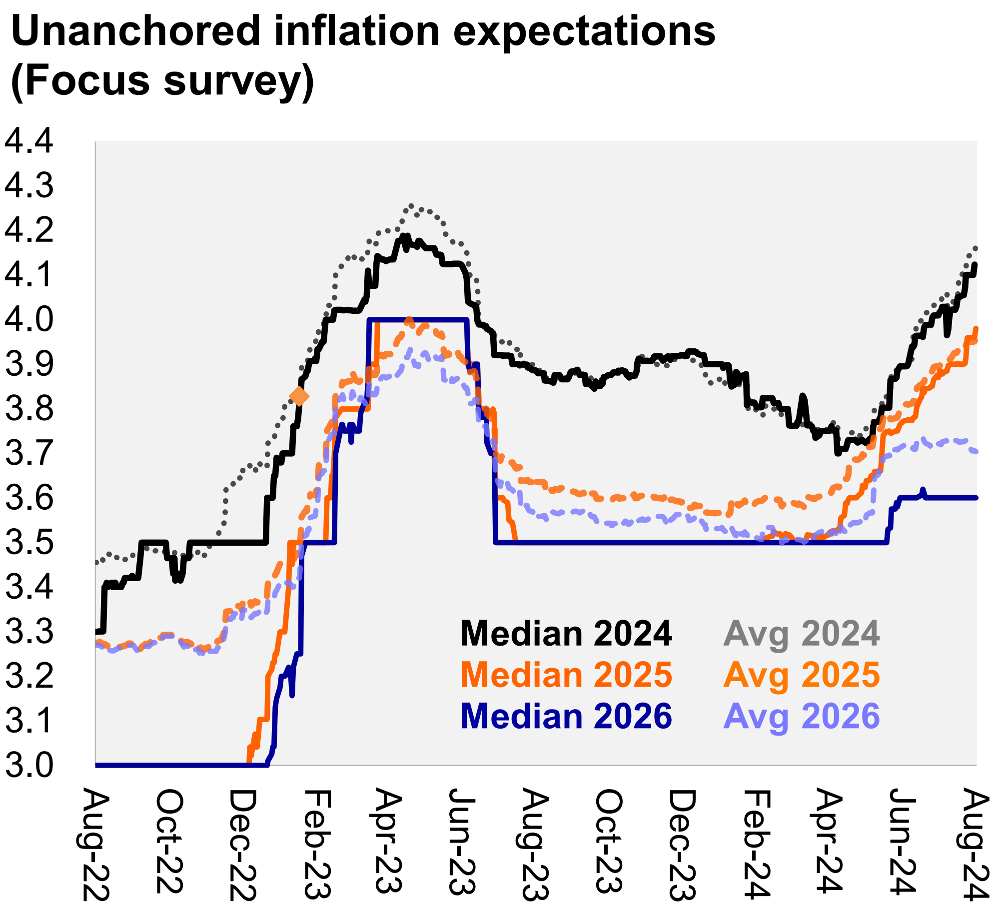
IPCA 2025



Source: IBGE, Itaú

Selic: How close is Brazil to a tightening cycle?

6. Inflation expectations are dis-anchored and getting worse, especially for 2025.



Source: BCB, Itaú

Selic: How close is Brazil to a tightening cycle?

7. We maintain our forecast for the Selic rate at 10.50%pa until the end of 2025, for now. But with higher risks, the leeway is decreasing

- If exchange rate movements and deteriorating expectations prove persistent, the monetary policy committee signaled (in the last minutes) that it will not hesitate to raise the interest rate.
- Simulating the model used by the Monetary Policy Committee (Copom), with the exchange rate at 5.70 reais per dollar, we find an inflation projection of 3.3% in the relevant horizon, above the target. In this case, according to our estimates, the interest rate level required to bring the IPCA back to the target would be at least 11.50% pa.
- In other words, if the exchange rate does not settle at a more appreciated level (in line with our scenario) and remains at the highs observed recently, the interest rate should be raised later this year.

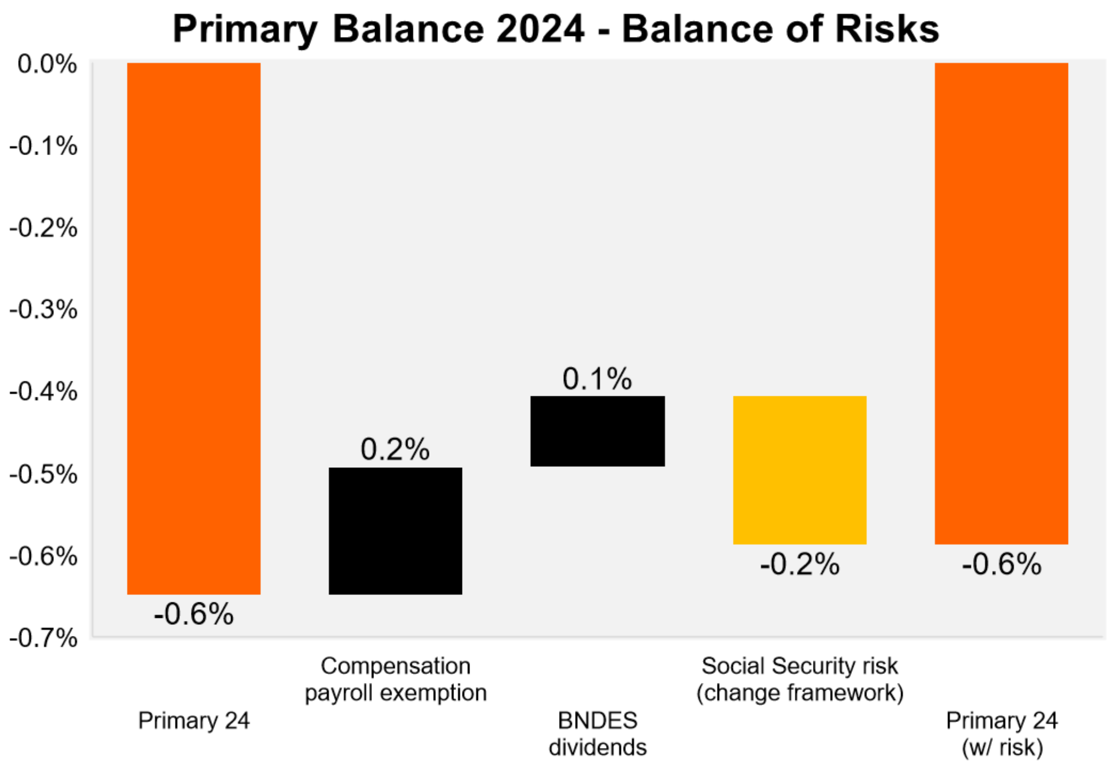
BRL	IPCA in 1Q26 with Selic Unchanged at 10.50%	Necessary Selic to bring inflation to the 3% target
5.10	2.8	9.75
5.30	2.9	10.25
5.55	3.2	11.00
5.70	3.3	11.50
5.90	3.5	11.75

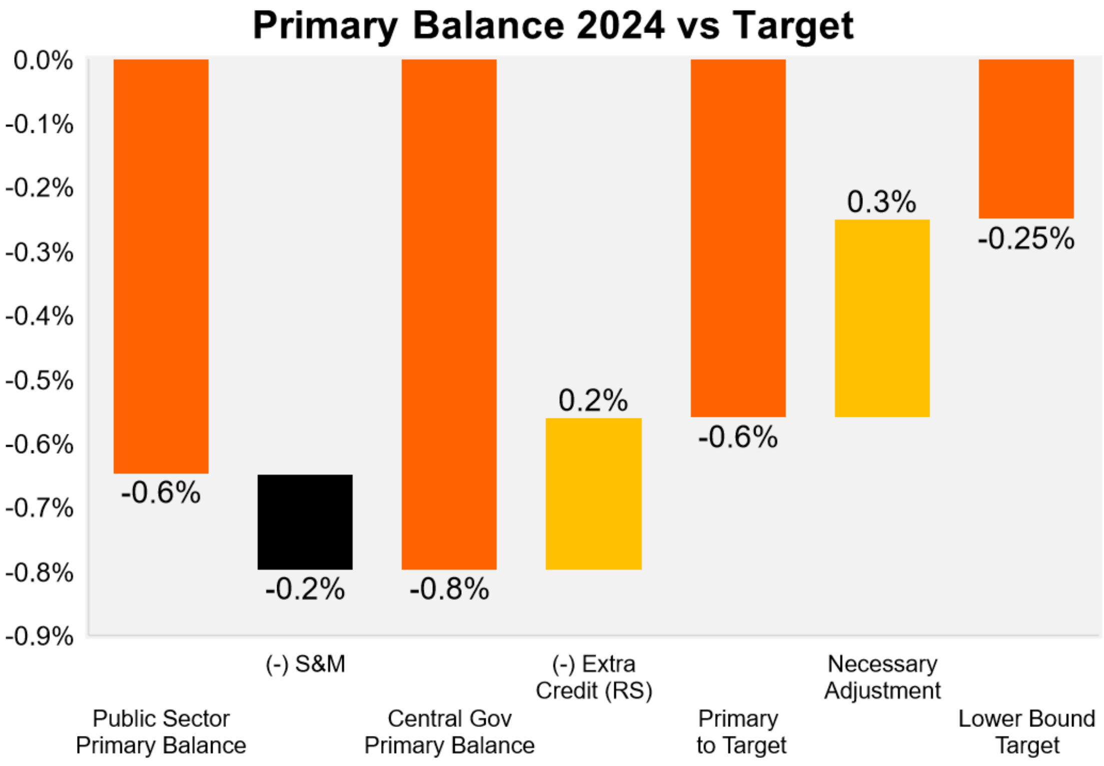
Source: BCB, Itaú

Fiscal: Compliance with the fiscal framework?

8. We maintain our estimates for primary budget results of -0.6% in 2024 and -0.9% in 2025

- Revenues keep growing, reflecting government measures (and activity), while mandatory expenses are not slowing down.
- With the government aiming for the low end of the limit (-0.25%), achieving the target for 2024 requires an additional effort of 0.3% of GDP with expense control and/or positive revenue surprises.
- Upcoming events: Annual Budget Bill - PLOA 2025 (Aug. 31), bimonthly reports (Sept/Nov.), and possible additional spending cuts (aiming at 2024 and 2025).





Source: BCB, National Treasury, Itaú

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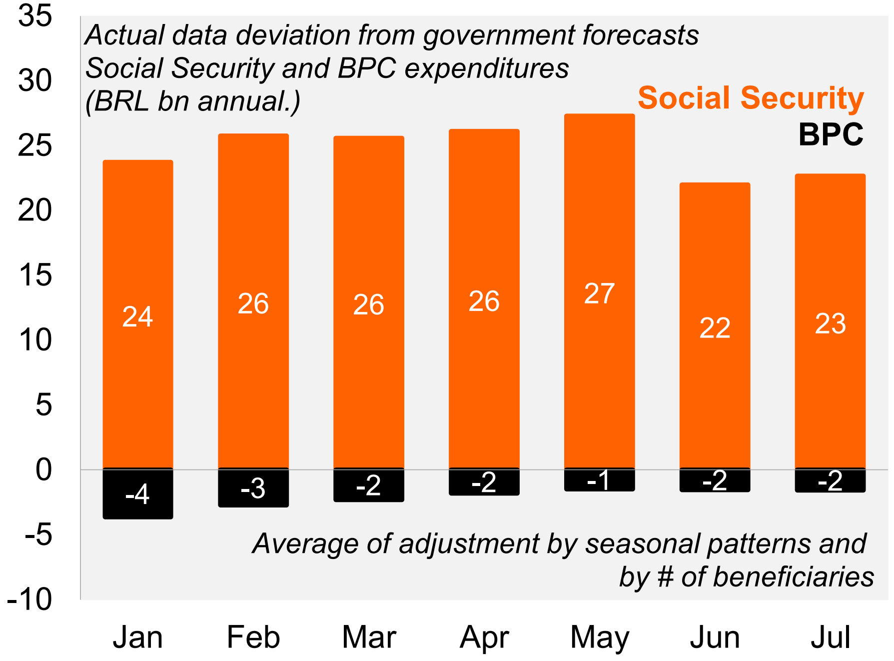
Fiscal: High risks and spending under pressure

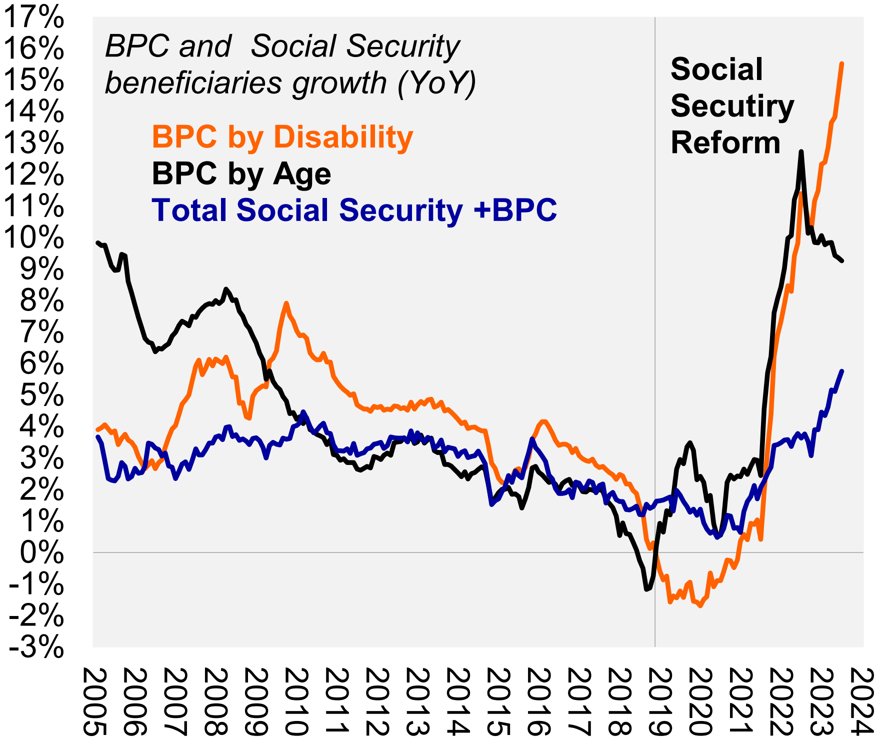
9. Spending adjustment of BRL 22 billion needed to meet the framework limit in 2024

- After a modest revision in the government's projection of mandatory spending and BRL 11 billion blocked, the need for spending cuts decreased to BRL 22 billion, leaving little room for disappointment beyond the historical pooling of BRL 15-20 billion
- The number of Social Security/BPC beneficiaries continues to increase rapidly. It is important to monitor the slowdown in 2H24.

With data until July, government needs to reduce BRL 22 bn in other expenditures to meet the limit set by framework



Growth in beneficiaries



Source: BCB, National Treasury, Itaú

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Brazil Forecasts:

	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	**2.5**	2.3	**1.8**	1.8
Nominal GDP - BRL bn	7,389	7,610	9,012	10,080	10,856	**11,560**	11,531	**12,267**	12,210
Nominal GDP - USD bn	1,872	1,475	1,670	1,951	2,175	**2,180**	2,212	**2,230**	2,280
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	**10,013**	10,162	**10,183**	10,412
Nation-wide Unemployment Rate - year avg, NSA	12.0	13.8	13.2	9.3	8.0	**7.1**	7.4	**7.4**	7.9
Nation-wide Unemployment Rate - year end (*)	11.6	14.7	11.6	8.5	8.0	**7.3**	7.8	**7.5**	8.0
Inflation									
IPCA - %	4.3	4.5	10.1	5.8	4.6	**4.2**	4.0	**4.2**	4.0
IGP–M - %	7.3	23.1	17.8	5.5	-3.2	**3.8**	3.3	**3.6**	3.1
Interest Rate									
Selic - eop - %	4.50	2.00	9.25	13.75	11.75	**10.50**	10.50	**10.50**	10.50
Balance of Payments									
BRL / USD - eop	4.03	5.19	5.57	5.28	4.86	**5.50**	5.30	**5.50**	5.40
BRL / USD - average	3.95	5.16	5.40	5.17	5.00	**5.30**	5.21	**5.50**	5.35
Trade Balance - USD bn	35	50	61	62	99	**75**	85	**70**	70
Current Account - % GDP	-3.5	-1.7	-2.4	-2.1	-1.0	**-2.0**	-1.2	**-2.1**	-1.6
Direct Investment (liabilities) - % GDP	3.7	3.0	2.8	4.7	2.9	**3.2**	3.2	**3.8**	3.8
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	**-7.1**	-7.2	**-7.6**	-7.5
Gross Public Debt - % GDP	74.4	86.9	77.3	71.7	74.4	**77.7**	77.9	**81.0**	81.4
Net Public Debt - % GDP	54.7	61.4	55.1	56.1	60.9	**62.8**	63.5	**66.8**	67.4

Source: IBGE, FGV, BCB and Itaú

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

Source: BBG, BCB, IBGE, National Treasury, Itaú

Macro Research – Itaú

Mario Mesquita – Chief Economist

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